Office-Supreme Court, U.S.
FILED
FEB 27 1981
ALEXANDER L. STEVAS,
CLERK

80-1484
No.

In the
Supreme Court of the United States
OCTOBER TERM, 1980

U.S. STEEL CREDIT CORPORATION,
Petitioner,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY, and AMERICAN FLETCHER CORPORATION,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT
(Seventh Circuit Nos. 80-1485, 80-1719)

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The Scheffer Press, Inc.—(312) 263-6850

QUESTIONS PRESENTED

1. Did the Court of Appeals err in affirming the District Court's judgment dismissing the securities fraud counts of Petitioner's counterclaim on the ground that Petitioner's participation shares in mortgage loan notes held by the Respondent Mortgage Company were not "securities" under the federal securities acts?

2. Did the Court of Appeals err in concluding that a participation share in a mortgage loan note held by a commercial lender is not an "investment" within the meaning of the Supreme Court's *Howey* and *Forman* decisions?

3. Did the Court of Appeals err in concluding that Petitioner's anticipated share of any interest paid on the loans was not an "expectation of profits" under the *Howey* and *Forman* decisions, because, said the Court of Appeals, "the rate of return was [not] in any way dependent on the actual profits, if any, of the project"?

4. Did the Court of Appeals err in concluding that under the *Howey* and *Forman* decisions the expected return on a mortgage loan participation is not "derived from the entrepreneurial or managerial efforts of others", if the investment decision is based in part on the participant's own business judgment and if the participation agreement prohibited modification of the loan or release of the collateral without participant's consent and authorized the participant to compel foreclosure in the event of a default?

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REPORT OF OPINION

The opinion of the United States Court of Appeals for the Seventh Circuit in this case has not yet been reported.

JURISDICTIONAL GROUNDS

The judgment and opinion of the United States Court of Appeals for the Seventh Circuit were rendered on November 3, 1980, and Petitioner's timely petition for re-hearing was denied on December 3, 1980.

Jurisdiction to review the Court of Appeals decision by writ of certiorari resides in the Supreme Court under 28 U.S.C. §1254 and is timely invoked pursuant to 28 U.S.C. §2101(c), as interpreted by Supreme Court Rule 20.4.

APPLICABLE STATUTES

At issue in this case are the substantially identical definitions of a "security" under the Securities Act of 1933 [15 U.S.C. §77b(1)], and the Securities Exchange Act of 1934 [15 U.S.C. §78c(a)(10)]:

> "When used in this title unless the context otherwise requires—
>
> "(1) The term 'security' means, any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest

or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. [15 U.S.C. §77b(1)]

"When used in this title unless the context otherwise requires—

"(10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." (15 U.S.C. §78c(a)(10))

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT
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STATEMENT OF THE CASE

This Petition for Certiorari seeks reviews by the Supreme Court of a decision of the United States Court of Appeals for the Seventh Circuit affirming a judgment of the United States District Court for the Southern District of Indiana, Indianapolis Division.[1] The sole ground of

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[1] Although there were several interlocutory orders of the District Court also involved in the appeal to the Seventh Circuit, the instant Petition seeks review of the Seventh Circuit's decision only insofar as it affirmed the District Court's judgment dismissing federal securities fraud counts of Petitioner's counterclaim against the Respondents and its Order denying Petitioner's motion for partial summary judgment on such securities counts.

the judgment and order in question was that certain participation shares acquired by Petitioner in mortgage loan notes held by Respondent, American Fletcher Mortgage Company, Inc. (the "Mortgage Company") did not qualify as "securities" under the applicable securities acts.

The instant litigation originated as two separate lawsuits filed on the same date, one filed by Petitioner against the Respondents in United States District Court for the Western District of Pennsylvania and the other by the Respondent Mortgage Company against Petitioner, U. S. Steel Credit Corporation ("USSC"), in the Indianapolis Division of the United States District Court for the Southern District of Indiana. Petitioner's Pittsburgh suit was for federal securities fraud in connection with the acquisition by Petitioner from the Mortgage Company of 40% participation shares in mortgage loans made by the Mortgage Company for the development and construction of a condominium project at Cromwell, Connecticut. Respondents, American Fletcher National Bank and Trust Company (the "Bank") and the parent corporation, American Fletcher Corporation ("AFC"), were charged with securities fraud liability, as "controlling persons" and "aiders and abettors" of the Mortgage Company.[2]

The Mortgage Company's Indianapolis suit was for alleged breach by Petitioner, USSC, of its commitment

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[2] The Pittsburgh suit also included counts for common law fraud and breach of the participation agreements, but those counts are not relevant to the instant Petition.

under the participation agreements to fund in full its share of the loan and certain related expenses.[3]

The District Court's jurisdiction of the Pittsburgh suit was based on federal question jurisdiction under 28 U.S.C. §1331, and jurisdiction of both suits was also based on diversity of citizenship under 28 U.S.C. §1332 (a).

The Pittsburgh suit was subsequently transferred to the District Court in Indianapolis, where it was consolidated with the Indianapolis suit. Since the issues in both suits were substantially the same, the action originally filed in Pittsburgh was thereafter dismissed and the counts of the Pittsburgh complaint were embodied in an amended counterclaim in the Indianapolis suit (App. pp. 28a-41a).

The events which led up to the instant litigation, as set forth in Petitioner's amended counterclaim[4] and in deposition testimony referred to in affidavits submitted with Petitioner's motion for partial summary judgment (App. pp. 77a-78a), were as follows.

In October, 1973, Petitioner received from the Mortgage Company 40% participation offerings in a $2,530,000 Land Acquisition and Development Loan (the "L&D

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[3] By subsequent amendment of the Indianapolis complaint, the Bank was added as a co-plaintiff, asserting rights as an alleged third-party beneficiary of the participation agreements and claims for interference with contractual relations, none of which rights or claims are at issue in this Petition.

[4] Since the District Court granted the Mortgage Company's motion to dismiss the "securities" counts (App. pp. 16a-22a), the facts set forth in the counterclaim must be taken as true, as well as the uncontroverted facts referred to in affidavits submitted by Petitioner.

Loan") and a $3,290,000 Construction Loan, which in March, 1973, the Mortgage Company had committed itself to make to a New York developer, Justin Development Corp. for the purchase, development and construction of a condominium complex in the Town of Cromwell, Connecticut. These loans were designed to cover the entire cost of land acquisition, development and first phase construction of the project.

In processing a loan, the Mortgage Company's practice was to obtain all pertinent information on the project, including appraisals, site survey, engineering and architectural plans and specifications, and market analysis; financial and other pertinent information on the borrower and its principal officers; similar information on the contractor, including the contractor's bonding capability; and full cost information, including estimated construction costs and cost breakdowns. (Trepinski dep., App. pp. 86a-88a). The Mortgage Company would then negotiate the terms of the loan with the borrower to fit the estimated costs, prepare the necessary documentation and issue loan commitments. (App. pp. 86a-88a)

In the case of the Cromwell L&D Loan, the Mortgage Company, prior to submitting its participation offering to Petitioner, entered into a written loan agreement with Justin Development Corp. and advanced to Justin major sums of its own money. The Mortgage Company then assembled the information it had gathered and submitted the same to Petitioner along with the participation offerings.

The participation offerings represented the Cromwell project as ultimately involving a total of 450 condominium units, of which 150 units were to be constructed in the

first phase of the project. The three-year mortgage loans were to be at "floating" rates of 5% over prime in the case of the L&D Loan, and 4% over prime in the case of the Construction Loan. The offerings also indicated that a 50% participation share had been offered to American Fletcher Mortgage Investors (the "Trust"), a Massachusetts real estate investors trust, and a 10% share to the Mortgage Company's affiliate, American Fletcher National Bank (App. pp. 41a-45a).

Unlike the Mortgage Company, Petitioner, USSC, was not staffed to originate or manage major real estate development loans (Thomas dep., App. pp. 81a-82a). Instead, USSC was engaged in the business of raising money, largely through the sale of commercial paper, and investing in loan participations like the Cromwell project (Mack dep., App. p. 80a). Generally, USSC's practice was to acquire minority participations in loans in which the lead bank had retained a major share (Thomas dep., App. p. 82a).

On the question of reliance upon the lead bank, Petitioner's representatives pointed out that a major factor was the reputation of the lead bank and the fact that the lead had substantial sums of its own money at stake (Lang dep., App. p. 81a; Thomas dep., App. p. 82a; Mack dep., App. pp. 80a-83a). There was further testimony on the management functions which were expected of a lead bank in the course of administration of a loan, e.g., periodic inspections of the progress of the work, obtaining certifications from inspecting architects or engineers, monitoring of disbursements to insure proper application of loan funds, periodic comparison of unconsumed loan balances with estimated cost to complete, negotiations with borrower to resolve any problems that might arise and

notification to participants of any problems (Mack dep., App. pp. 84a-85a). Of course, Petitioner also relied on the lead bank to see to it that the loans were properly closed and loan documents properly executed (Mack dep., App. p. 85a).

After studying the participation offerings and the data supplied by the Mortgage Company and visiting the Cromwell site, but with reliance upon the truth, accuracy and completeness of the Mortgage Company's material representations and disclosures (Counterclaim ¶¶6-11, App. pp. 29a-35a) Petitioner prepared, executed and sent the participation agreements to the Mortgage Company for signature. These were subsequently executed by the Mortgage Company under date of December 31, 1973 (see Participation Agreement, App. pp. 45a-52a).

In effect, the participation agreements involved the acquisition by Petitioner of 40% shares of whatever amounts the Mortgage Company might recover on the Cromwell loans, whether by payments on the notes, by foreclosure against the security, or otherwise.

These agreements required the Mortgage Company to hold in trust, for the benefit of Petitioner, the notes, the security, all instruments related to the loan obligation and all proceeds and avails thereof, while prohibiting the Mortgage Company from modifying the terms of the loan obligation or releasing any of the security without written consent of Petitioner.

The participation agreements established a procedure for advance notification to Petitioner of amounts due from Petitioner as its share of proposed disbursements on the loan and provided that such notification would be deemed a representation by the Mortgage Company that there

was no material breach of the loan agreement of which the Mortgage Company was aware.

The Mortgage Company was required to "administer" the loan obligation in accordance with the terms of the Loan Agreements, but the Mortgage Company's liability for loan mismanagement was limited to willful misconduct, bad faith or gross negligence.

Provision was also made for prompt notice to Petitioner by the Mortgage Company of any material default in the terms of the loan obligation or any other matter which, in the Mortgage Company's judgment, adversely affected Petitioner's interest.

The agreements went on to provide that in the event of any material default, the Mortgage Company shall exercise all of its rights to enforce collection of the loan obligation either upon its own initiative or upon request of Petitioner.

The participation agreements prohibited any sale or other dispostion by the Mortgage Company or by Petitioner of the note or the participation, but authorized the Mortgage Company to redeem Petitioner's participation by payment to Petitioner of all amounts due upon the same.

Neither party to the Participation Agreements construed the same as vesting in Petitioner any interest in the unpaid loan or any rights against Justin Development Corp., the borrower. (Mack Supp. Aff., App. p. 91a).

The counterclaim with detailed particularity, charges the Mortgage Company with more than fifteen deliberate or reckless misrepresentations or non-disclosures of material fact (Counterclaim ¶¶6-9, App. pp. 29a-34a), notably:

1. That over a sixteen months period from the date of closing of the Construction Loan in February, 1974, until mid-June, 1975, the Mortgage Company collected more than $2,000,000 from USSC without disclosing to USSC that disbursements on the loan were not legally obligatory because the borrower had failed to comply with the express conditions of the loan agreement that it submit a proper construction contract and performance bond. (Counterclaim ¶7, App. p. 30a);

2. That the Mortgage Company failed to disclose to USSC that it had thrown the Construction Loan out of balance by advancing to the borrower the amount of interest payments on the Construction Loan, despite the fact that there were no funds budgeted for the payment of interest under the Construction Loan. (Counterclaim ¶9(a), App. p. 31a);

3. That the Mortgage Company failed to disclose to USSC that prior to the closing of the Construction Loan, the Mortgage Company's legal counsel in charge of closing and administering the loan had warned that the loan would be inadequate to complete development and construction of the first phase of the Cromwell project. (Counterclaim ¶9(i), App. p. 33a).

On January 7, 1980, the Mortgage Company filed a Motion to Dismiss or for Judgment on the Pleadings as to Securities Law Claims (App. pp. 75a-76a).

USSC responded on February 22, 1980, with a Cross-Motion for a partial summary judgment declaring its participations to be "securities" under federal and state securities acts (App. pp. 77a-78a).

On March 21, 1980, the District Court issued an Order granting the Mortgage Company's Motion to Dismiss or for Judgment on the Pleadings on the securities counts of USSC's counterclaim, and at the same time denied USSC's Cross-Motion (App. pp. 16a-22a). This Order, as amended to include a Rule 54(b), F.R.Civ.P., certification and direction for entry of final judgment (App. pp. 23a-25a), was affirmed by the Court of Appeals, precipitating the instant Petition.

ARGUMENT

A. Seven Reasons for Granting Petition.

1. As inflation accelerates and the number of multi-million dollar development and construction loans multiplies, more and more lenders are raising capital and spreading risks by selling loan participations. These are often sold to distant participants, who have little independent knowledge of the borrowers or of the projects for which they seek to borrow, and who must, therefore, rely upon the lead bank to investigate, evaluate and negotiate loans sufficient for the borrowers' financial needs; to supply prospective participants with complete and accurate information sufficient for intelligent investment decisions; to manage the loans once consummated; to supervise the application of loan funds, and to monitor the progress of the work for which the funds are loaned.

It thus becomes a matter of increasing national importance for the Supreme Court to resolve the question, whether and to what extent participation shareholders are entitled to the protection of the federal securities acts.

2. It is submitted that decisions like the Seventh Circuit's decision, below, spring from the tacit belief that major corporate investors do not need the protection of the securities acts. This theory has led to distortions of the Supreme Court's guidelines for testing securities status and to frustration of the Congressional intent reflected in the Securities Acts. None of these guidelines or enactments suggests any purpose to limit the Acts to small or unsophisticated investors. To the contrary, see *United States* v. *Naftalin,* 441 U.S. 768, 99 S.Ct. 2077 (1979).

While unsophisticated investors are, perhaps, more easily duped, it does not follow that major investors need no securities act protection. First, the absence of such protection tends to dry up this important source of capital. Secondly, practical necessities require that loan participants, with millions entrusted to their lead banks, must have faith and confidence in their leads and avoid the disruptive effect of policing their leads for potential misconduct or mismanagement. Finally, one must remember that losses suffered by corporate investors for want of securities act protection will ultimately devolve upon their shareholders, often small investors of modest means. See *Eason* v. *General Motors Acceptance Corporation,* 490 F.2d 654, 657 (7th Cir. 1973)

3. Contrary to the Supreme Court's repeated admonitions that the Securities Acts should be construed broadly and flexibly to achieve their remedial purposes [*Tcherepnin* v. *Knight,* 389 U.S. 332, 336, 88 S.Ct. 548, 553 (1967); *Aaron* v. *SEC,* 100 S.Ct. 1945, 1960 (1980)], the instant decision of the Seventh Circuit narrowly construes the Supreme Court's guidelines for determining securities status by ruling that interest is not a form of "profits" and by restrictively applying the *Howey-Forman* profits-derivation test.[5]

4. Contrary to the Supreme Court's admonition in *Forman,* 421 U.S. 837, 848, 95 S.Ct. 2051, 2058 (1975) that in construing the term, "security," "form should be disregarded for substance and the emphasis should be upon economic reality," the Court of Appeals held that interest was not "profits" because the rate of return on

[5] See *SEC* v. *W. J. Howey,* 328 U.S. 293, 301, 66 S.Ct. 1100, 1104 (1946); *United Housing Foundation* v. *Forman,* 421 U.S. 837, 852, 95 S.Ct. 2051, 2060 (1975).

the notes was wholly independent of any profits (App. p. 13a), ignoring the "economic reality" that without profits there would be no return on these notes.

5. In holding that where a prospective loan participant's expectation of profits derives in part from the participant's own evaluation of the investment opportunity, there is no "expectation of profits to be derived from the entrepreneurial or managerial efforts of others" within the meaning of *Forman, supra,* 421 U.S. p. 853 (App. p. 14a), the Court of Appeals misconceived the profits-derivation test in two respects: first, in regarding the "efforts of others" requirement as looking to the source of the *expectation* of profits rather than merely to the source of the profits, and, secondly, by construing *Forman* as requiring that the profits *expectation* must derive *solely* from the "efforts of others."

The Supreme Court's *Howey-Forman* formulation is in need of clarification on this point.

6. Likewise, the Court of Appeals' holding (App. p. 14a) that Petitioner's reservation under the participation agreements of rights to prohibit changes in loan terms or release of the security and to demand foreclosure in case of default precluded any inference of reliance upon the managerial efforts of others, would disqualify, for example, a corporate mortgage bond as a "security," since all of the above rights are possessed by bondholders.

7. While the Second Circuit has not ruled on the precise question, whether a loan participation is a "security," its liberal approach to the "securities" Acts definitions, as formulated in *Exchange National Bank* v. *Touche Ross & Co.,* 544 F.2d 1126 (2nd Cir. 1976), stands in marked contrast to the restrictive interpretation of the Seventh and some other Circuits.

Touche Ross reflects a disposition to give broad scope to the Securities Acts—as, indeed, the Supreme Court has urged—by presuming instruments, expressly defined as "securities," to be what Congress says they are, unless the opposing party sustains the burden of proving that "the context[6] otherwise requires." Following this approach, two District Court decisions in the Second Circuit have held loan participations to be "securities." *Commercial Discount Corp.* v. *Lincoln First Commercial Corp.,* 445 F.Supp. 1263 (SDNY 1978) and *NBI Mortgage Investment Corp.* v. *Chemical Bank,* [1976-1977] Fed. Sec. L. Rep. (CCH) ¶95,632 (SDNY 1978) and [1977-1978] Fed. Sec. L. Rep. ¶96,066 (SDNY 1977).

Unlike *Lehigh Valley Trust Co.* v. *Central National Bank of Jacksonville,* 409 F.2d 989 (5th Cir. 1969)[7], the

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[6] "Context" looks to "surrounding factual circumstances" [*Emisco Industries, Inc.* v. *Pro's Inc.,* 543 F.2d 38, 39 (7th Cir. 1976)] including "the actual facts and circumstances of the investment arrangement", *Goodman* v. *Epstein,* 582 F.2d 388, 406 (7th Cir. 1978).

[7] *Lehigh Valley* held that a loan participation was a "security" because so defined in the Acts. Though its literal approach has been repudiated, it reached the correct result on the facts described in the opinion. Recently, in *United American Bank of Nashville* v. *Gunter,* 620 F.2d 1108 (5th Cir. 1980), the Fifth Circuit affirmed a District Court holding that loan participations were not within the Securities Acts. *Gunter,* however, presented peculiar facts in that the participant and the lead bank were affiliates, and, as a matter of routine, the participant took whatever participations the lead offered from time to time without question or expectation that the lead would keep it informed of material facts. Thus, there was no reliance by the participant on representations or disclosures of the lead which could support a securities fraud claim. In affirming, *per curiam,* the District Court in Nashville, the Fifth Circuit, significantly, disavowed approval (fn. 2,

Second Circuit's approach gives full consideration to the "context," but resolves doubts in favor of *inclusion*. The Seventh Circuit, by contrast, resolves doubt, in favor of *exclusion*.

B. Whether or not the Notes Were "Investments" by Respondent Mortgage Company, Petitioner's Participations therein were "Investments."

The Supreme Court has repeatedly emphasized that federal securities legislation should be construed, "not technically and restrictively, but flexibly to effectuate its remedial purposes," *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195, 84 S.Ct. 275, 285 (1963); *Aaron* v. *SEC*, ... U.S. ....., 100 S.Ct. 1945, 1960 (1980). The purpose of the Securities Acts was summarized in the Senate Report on the Bill for the 1933 Act, as follows:

> The purpose of this Bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation, S. Rep. No. 47, 73d Cong., 1st Sess., to accompany S. 875, April 27, 1933.

The Supreme Court's fourfold guidelines for testing "security" status, as initially laid down in *SEC* v. *W. J.*

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[7] (Continued)
620 F.2d p. 1110) of two other District Court decisions on which the District Court in Nashville had based its holding that participations were not "securities." The District Court decisions in question were *FBS Financial* v. *CleveTrust Realty Investors*, Fed. Sec. L. Rep. (CCH) ¶96,341 (N.D.Ohio 1977), and *Provident Nat. Bank* v. *Frankford Trust Co.*, 468 F.Supp. 448 (E.D.Pa. 1979), both relied upon by the District Court, below, in the case at bar.

Howey, 328 U.S. 293, 301, 66 S.Ct. 1100, 1104 (1946), was further refined in *United Housing Foundation* v. *Forman*:

> The touchstone is the presence of [1] an investment in [2] a common venture premised on [3] a reasonable expectation of profits to be derived from [4] the entrepreneurial or managerial efforts of others.
> 421 U.S. at 852, 95 S.Ct. at 2060

Accordingly, the initial question is whether Petitioner's Cromwell participations were "investments." Like the District Court, the Seventh Circuit concluded that the Cromwell participations met none but the "common venture" test of *Howey-Forman* (App. p. 12a). No explanation was offered for denying that the participations were "investments." In common usage, an "investment" is "an expenditure of money for income or profit", Webster's New International Dictionary Unabridged (3rd Ed., 1965). Assuming that *Howey-Forman* used the term in that broad sense, one may "invest" in a non-security, and there may be "security" transactions, e.g. gifts, which involve no "investment".[8]

It is submitted that *Howey-Forman* intended to characterize as an "investment" any profit-motivated expenditure, even one not involving the acquisition of a "security" by reason of other aspects of the *Howey-Forman* test. That profit-motivation is the key to an investment is consistent with the holdings of *United Housing Foundation* v. *Forman,* 421 U.S. 837, 95 S.Ct. 2051 (1975) that

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[8] Illustrative of a "securities" transaction not involving an "investment", was *Lincoln National Bank* v. *Herber,* 604 F.2d 1038 (1979), where the Seventh Circuit held that a pledge of stock to secure a loan was not within the Securities Acts. *Herber* has been repudiated, however, by the Supreme Court's recent decision in *Rubin* v. *United States,* ..... U.S. ....., 41 CCH S.Ct. Bull. p. B824 (1981).

housing co-op "stock certificates" did not qualify, where purchasers were motivated by a desire for housing, rather than profits, and by *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551, 99 S.Ct. 790 (1979), holding that union pension funds were not securities, where the inducement was employment, rather than pension profits. In *Tcherepnin* v. *Knight,* 389 U.S. 332, 88 S.Ct. 548 (1967), on the other hand, savings and loan certificates were held to be covered, when acquired for profit.

C. Petitioner's Expected Return on its Participations was an Expectation of "Profits" under Howey-Forman.

The Seventh Circuit's holding to the contrary was based upon the following rationale:

> "Steel [Petitioner] was not to participate in any of the profits from the Justin project, and neither the repayment of the loan nor the rate of return was in any way dependent on the actual profits, if any, of the project". (App. p. 13a)

This reasoning is faulty in several respects. First, the statement that the "rate of return" was not dependent upon profits is true of any interest-bearing instrument. To regard this fact as disqualifying is, in effect, to read out of the Securities Acts interest-bearing instruments, such as notes, participations and certificates of deposit,[9] which Congress expressly included in its broad definitions of "securities."

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[9] See *Canadian Imperial Bank of Commerce Trust Co.* v. *Fingland,* 615 F.2d 465 (7th Cir. 1980), holding that certificates of deposit were not "securities", largely on the theory that interest was not "profits".

Secondly, to say that the rate of return was not dependent on profits, is true only in a legal sense. As directed in *Forman*, however, in construing the Securities Acts, "form should be disregarded for substance and the emphasis should be upon economic reality". 421 U.S. at 848. The "economic reality" of 100% loans like the Cromwell loans is that in the absence of profits, there will be no return of either principal or interest on the notes. Though apparently lost on the Seventh Circuit, this point was recognized by the Fifth Circuit in *Williamson* v. *Tucker*, 632 F.2d 579, 604 (5th Cir. 1980):

> But a note holder may nevertheless be *dependent* on the *profitability* of the enterprise for the payment of interest or the return of principal. Unless the note holder's reliance on the success of the enterprise is insignificant, the holder can be said, in effect, to share in the profits of the enterprise in the sense contemplated by the Supreme Court in *Forman* (Emphasis the Court's).

Third, consistent with its policy of construing the Securities Acts broadly, the Supreme Court in *Tcherepnin* v. *Knight*, 389 U.S. 332, 338, 88 S.Ct. 548, 554 (1967) expressly described as "profit" the interest return upon the loans of a savings and loan association. Holding that withdrawable certificates in a savings and loan association were "securities", the Court stated in *Tcherepnin*:

> Petitioners are participants in a common enterprise —a *money lending operation* dependent for its success upon the skill and efforts of the management of City Savings in making sound loans . . . [T]he petitioners can expect a return on their investment only if City Savings shows a *profit*. (Emphasis added.) 389 U.S. at 339, 88 S.Ct. at 55

Whether or not commercial loan notes in the hands of a commecial lender qualify as "securities" under the profits-derivation test of *Howey-Forman,* there is no justification for disqualifying them by narrowly defining "profits" to exclude interest.

Fourth, the lender's expected return on its notes must be differentiated from the participant's expected return on its participations. The lender has an absolute right of repayment of principal and interest on the notes. The participant, by contrast, has no rights against the borrower. The participant's sole right is to share in whatever return, *if any,* the lead bank realizes on its note. See *In Re Yale Express System, Inc.,* 245 F.Supp. 790, 792 (SDNY 1965), so holding. As stated in *Janik, The Colocotronis Dispute: When is a Loan Participation Share a Security,* 13 J. Int'l. Law & Econ. 165, 179 (1978):

> Finally, it is critically important to always recall that the participants, holding no notes, had no right against the Colocotronis group [borrowers]. These factors clearly indicate that even though their money was used by a borrower, the participants were not loaning their funds; they were investing their funds.

D. As a Participant, Petitioner Necessarily Looked to the "Entrepreneurial or Managerial Efforts" of the Respondent Mortgage Company for any Profits on the Cromwell Participations.

The fourth element of the *Howey-Forman* test is somewhat ambiguous. This fourth element stipulates that the reasonable expectation of profits is "to be derived from the entrepreneurial or managerial efforts of others", *United Housing Foundation* v. *Forman,* 421 U.S. 837, 852, 95 S.Ct. 2051, 2060 (1975). Does this profits-deriva-

tion test look only to the derivation of the future profits, or to the derivation of the profits *expectation*, or to both?

It will be recognized that if "efforts of others" must be the source, not only of the future profits, but also of the investor's *expectation* of profits that prompts his investment, few investments will qualify as "securities." This follows because every prudent investor relies in part—and often in large part—on his own evaluation of the prospective investment. Is it, then, the policy of the Securities Acts to protect only *imprudent* investors, and penalize those who look before they leap? Apparently, that is how the Seventh Circuit construed the profits-derivation test when it ruled that Petitioner was not "dependent upon the Mortgage Company's entrepreneurial efforts", because "Steel's decision to enter the participation agreement was based on its own business judgment" (App. p. 14a).[10]

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[10] If this was a finding that Petitioner did *not* rely upon the truth, accuracy and completeness of the material representations and disclosures presented by the Mortgage Company as inducements to Petitioner to purchase its participations and to continue disbursements under them, then it was a wholly improper finding on a disputed issue of material fact. The judgment dismissing the securities counts of Petitioner's counterclaim was a judgment on a Rule 12(b)(6) F.R.civ.P., motion to dismiss, under which the factual averments of the pleadings sought to be dismissed must be taken as true, except to the extent controverted by any evidentiary matter considered by the Court. Petitioner's counterclaim includes an averment that Petitioner did rely to its detriment upon the truth, accuracy and completeness of the Mortgage Company's representations and disclosures. The deposition testimony that Petitioner visited the job site and studied the material submitted by the Mortgage Company (see p. 6, *supra*) is entirely consistent with this averment, demonstrating no more than common investor's prudence.

It is submitted that the language used in *Forman* to describe the profits-derivation test, particularly when read back into the *Howey* decision, where it originated, shows that efforts of others must be the source of the profits, but not necessarily the source—and certainly not the sole source—of the profits *expectation* which induced the investment. Thus, *Forman* speaks of an "expectation of profits", *to be derived* from the efforts of others. "To be derived" is language of futurity, indicating that *future* efforts of others will give rise to the profits. But since the efforts giving rise to the *expectation* of profits have already been expended, the future tense, "to be derived", is inappropriate language for describing the efforts that created the *expectation* of profits.

Compare the *Howey* formulation, where an "investment contract" was simply defined as "an investment of money in a common enterprise with profits to come solely from the efforts of others," *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 301, 66 S.Ct. 1100, 1104 (1946). It is clear that under the *Howey* formulation, only the profits need "come solely from the efforts of others", whatever may have given rise to the expectation of profits that prompted the investment. There is nothing in *Forman* to suggest an intent to change the *Howey* rule, except the elimination of the term "solely" as applied to the "efforts of others."

In striking the term "solely," the court in *Forman*, 421 U.S. 837, 852, 95 S.Ct. 2051, 2060, fn. 16, took note of the Ninth Circuit's holding in *SEC* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973) that the language, "solely from the efforts of others," should not be so rigidly applied as to preclude "securities" status for an investment contract in which the investor's own efforts made some minor contribution to profits. In

Turner Enterprises the Ninth Circuit concluded that the *Howey* "efforts of others" test had been satisfied so long as:

> the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise. 474 F.2d at 482.

Although the Supreme Court in *Forman* declined to pass judgment on the holding in *Turner Enterprises,* its consideration of that case in conjunction with deletion of "solely" from its restatement of the "efforts of others" requirement must reflect a deliberate decision to disregard inconsequential activities of investors in relation to profits. Certainly, such minor activities of an investor as a visit to a job site would not be disqualifying.

The question next arises as to whether a lender, in financing a construction project, for example, makes such a significant contribution to the success and profitability of the project that the anticipated profits from the loan will not be deemed "to be derived from the entrepreneurial or managerial efforts of others". It is this problem, and not the exercise in semantics that leads to characterization of a bank loan as a non-investment "commercial loan", *C.N.S. Enterprises, Inc.* v. *G & G Enterprises, Inc.,* 508 F.2d 1354 (7th Cir. 1975), *cert. denied* 423 U.S. 825, which casts doubt upon the "securities" status of bank loan notes in the hands of the lending bank. Adequate financing of a major construction project is not merely important, but crucial. Accordingly, a bank's entrepreneurial activities in appraising the property, evaluating market prospects, estimating construction costs, analyzing the borrower's financial resources, and realistically calculating the borrower's total financial needs, are major essentials to profitability.

But precisely because of the vital role which a bank plays in creating and managing a loan, when that same bank goes into the market place and invites investors to purchase major participations in its loan in reliance upon its expertise as a lender and loan manager, it should be held to the same standards of full and fair disclosure which would obtain if it were selling its corporate shares. This distinction between the posture of the lead bank as a commercial lender and the posture of a participating shareholder, who takes no part in the creation or management of the loan, has been recognized by the better reasoned cases and articles.

Thus, in *United California Bank* v. *THC Financial Corp.*, 557 F.2d 1351 (9th Cir. 1977), the Ninth Circuit, while holding that non-negotiable short term notes (one month) secured by receivables were not "securities," distinguished the case of a loan participation. Though criticizing as an overly "literal reading of the statute" the Fifth Circuit's decision in *Lehigh Valley Trust Co.* v. *Central National Bank,* 409 F.2d 989 (5th Cir. 1969), in which it held that a loan participation was necessarily a "security" because the statute so defined it, the *United California Bank* court went on to say:

> [T]his case [Lehigh Valley Trust] remains vital by instructing that, while the underlying note may not be a security, *the participation interest may fall within the definition of a security.* Cf. *Avenue State Bank* v. *Toutrelot,* 379 F.Supp. 250, 254 (N.D.Ill. 1974). 557 F.2d at 1357, fn. 8.

This distinction was also recognized in *Commercial Discount Corporation* v. *Lincoln First Commercial Corporation,* 445 F.Supp. 1263 (SDNY 1978), where the court held that CDC's purchase of a participation in Lincoln First's (the lead bank's) secured short term loans to Piccard was an investment in a "security":

> CDC's [the participant's] contractual relationship under this agreement was with Lincoln First [the lead bank], not with Piccard [the borrower]. CDC did not lend money to Piccard, nor did it hold evidence of indebtedness signed by Piccard. Furthermore, CDC had no direct interest in the collateral (the accounts receivable in the inventory) pledged by Piccard, though it did have a right to participate in any 'amounts received by [Lincoln First] through realization upon the specific collateral, in repayment of the principal amount of the advances' and even though Lincoln First agreed to hold the collateral 'as agent of and trustee for' CDC. 445 F.Supp. at 1265.

Differentiating the position of a loan participant from that of the lead bank, the author of a law review note states:

> Typically, the lead bank not only negotiates the terms of the loan with the client, but also actually makes the loan from its own reserves. Thus the lead is the sole party holding any documentation, collateral or rights against the borrower. After the loan has been made, the lead will then line up syndicate members, who in turn purchase a participation share evidencing a share in the loan. * * *
>
> Janik, *The Colocotronis Dispute: When Is a Loan Participation Share a Security,* 13 J. Int'l. Law & Econ. 165, 170 (1978).[11]

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[11] See also notes, *Loan Participations as Securities,* 8 Cal. W. Int'l. L. J. 510, 520 (1978), and *Bank Loan Participations: The Affirmative Duty to Disclose Under SEC Rule 10b-5,* 27 Syracuse L. Rev. 807, 816 (Spring 1976): "The participation certificate merely symbolizes the right of the participant to share pro rata in the profits or losses derived from the venture. It gives the participant the right to proceed against neither the lead nor the borrower in the event of default."

The principal reason for treating a participation share as a "security", even though the underlying note is not, is that the participation shareholder stands at a remove from the venture being financed and must rely chiefly upon the lead bank, not only for information concerning the project, but also for management of the loan when consumated. As observed by Judge Wright in his special concurring opinion in *Great Western Bank & Trust* v. *Kotz,* 532 F.2d 1252, 1261-1262 (9th Cir. 1976):

> "While banks are subjected to risks of misinformation, their ability to verify representations and take supervisory and corrective action places them in a significantly different posture than the investors sought to be protected through the securities acts. "In an investment situation, the issuer has superior access to and control of information material to the investment decisions. . . . The commercial bank deals 'face-to-face' with the promissor [borrower]."

In like vein, see California Western Law Journal:

> [E]ven if a participating bank were to employ outside consultants and advisors, it could never put itself in the position of the informed lead lenders who work closely with the borrower in developing and supervising the loans. . . . Thus, the participants had no choice but to rely on EAB, as lead lender, for their credit evaluation and their ability to negotiate loan covenants and restrictions. Subsequent to the purchase of participations and the loan being made, reliance on EAB necessarily continues for loan surveillance and administration, 8 Cal. West. L. J. 510, 532 (1978).

As regards the rights reserved to Petitioner under the participation agreements to veto any change in the loan terms for release of the collateral and to require

foreclosure in the event of a default, those are merely the rights of any bondholder. If those minimal rights for protection of the investment were disqualifying, it would not be true as stated by this Court in *United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837, 850, 95 S.Ct. 2051, 2059 (1975) with reference to a "note, a bond, or a share of stock" that, "most instruments bearing those traditional titles are likely to be covered by these statutes."

For all of the foregoing reasons, this Petition should be granted.

Respectfully submitted,

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Office Supreme Court, U.S.
FILED
FEB 27 1981
ALEXANDER L. STEVAS,
CLERK

80-1484
No.

In the
Supreme Court of the United States
October Term, 1980

U. S. STEEL CREDIT CORPORATION,
Petitioner.

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY, and AMERICAN FLETCHER CORPORATION,
Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT
(Seventh Circuit Nos. 80-1485, 80-1719)

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The Scheffer Press, Inc.—(312) 263-6850

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
For The Seventh Circuit

Nos. 80-1485, 80-1719

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,

Plaintiffs-Appellees,

vs.

U. S. STEEL CREDIT CORPORATION,

Defendant-Counterclaimant (Appellant),

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY and AMERICAN FLETCHER CORPORATION,

Counterdefendants (Appellees).

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. IP 76-276-C—WILLIAM E. STECKLER, *Judge.*

HEARD SEPTEMBER 23, 1980—DECIDED NOVEMBER 3, 1980

Before CUMMINGS and WOOD, *Circuit Judges*, and CAMPBELL, *Senior District Judge.**

* The Honorable William J. Campbell, Senior District Judge of the Northern District of Illinois, is sitting by designation.

CUMMINGS, *Circuit Judge*. In this diversity case, defendant U. S. Steel Credit Corporation appeals in No. 80-1719 from the district court's interlocutory orders denying defendant's motion for partial summary judgment on plaintiffs' amended and supplemental complaint and defendant's motion for a summary judgment declaring the loan participations in issue to be "securities" within the meaning of federal and Indiana securities laws, and in No. 80-1485 from the district court's final order dismissing the securities fraud counts of defendant's amended counterclaim. We affirm.

I. *Introduction*

On April 10, 1976, plaintiffs brought this action to recover monies allegedly disbursed on behalf of defendant U. S. Steel Credit Corporation (Steel) pursuant to certain loan participation agreements. The facts *according to the amended and supplemental complaint* are as follows:

In 1973, the American Fletcher Mortgage Company (Mortgage Company) agreed to make two loans totaling $5,820,000 to Justin Development Corporation to acquire land in Cromwell, Connecticut, and construct residential condominiums thereon. In the same year the Mortgage Company entered into participation agreements with defendant Steel, American Fletcher National Bank (Bank) and American Fletcher Mortgage Investors Trust (Trust). Those three institutions agreed to supply the funds to the Mortgage Company for disbursement to the borrower in shares of 40% by Steel, 10% by the Bank, and 50% by the Trust. The three participants were to receive payments of principal and interest from the borrower equal to their proportionate shares of the loans.

In 1974-1975, the project encountered adverse economic conditions. Therefore, in March 1975 the Mortgage Company proposed an increase of the loans to provide necessary funds. By the end of April 1975, the Mortgage Company's proposal had been approved by the Bank and the Trust, but not by Steel, which failed to respond to the proposal throughout the summer of 1975. Consequently,

the Mortgage Company was *unable* to implement the proposal, and the borrower fell into default on its obligations to the lenders and its general contractor.

On October 10, 1975, the Mortgage Company, with the consent of the three participants, entered into a settlement with Justin, its general contractor and the loan guarantors. Under the settlement, the Mortgage Company took title to the project and disbursed funds due the general contractor and various creditors of Justin and generally released Justin, the general contractor and the guarantors. At that time, less than 50 of the project's units had been completed and the rest were still under construction. No sales could be closed without the prompt completion of additional units. After the settlement, Steel demanded that the Mortgage Company purchase its interest *at an inflated price.*

In conjunction with the settlement and prior thereto, the Mortgage Company disbursed $734,929.59 from loan proceeds on behalf of the three participants. Steel has failed to reimburse the Mortgage Company in the amount of $293,962.83, its 40% share of the disbursements, which the Mortgage Company claims to have been due from Steel as of October 16, 1975. As of February 28, 1978, the Mortgage Company had expended an additional $400,-541.73 to preserve the project, and Steel therefore allegedly also owes the Mortgage Company 40% of those expenditures, namely $160,216.69.

In March 1976, the Mortgage Company made a formal proposal to Steel to develop the project by constructing certain condominium units and engaging in an April 1976 marketing program. Steel did not respond to the proposal, which was approved by the Trust and the Bank, until after the summer of 1976, by which time the prime construction and selling season had passed, thereby resulting in a further decline in the project's value.

In January 1977, Steel gave conditional agreement to a proposal to list the project for sale "as is" for $1,700,-000. For the next three months, however, Steel refused

to give its *formal consent* unless the Mortgage Company, the Bank and the Trust agreed to waive all claims they had against Steel. This further delayed disposition of the project so that the Mortgage Company was unable to find a buyer even at the $1,700,000 price.

The plaintiffs then proceeded to file their amended and supplemental complaint. In Count I, the Mortgage Company sought damages of $454,179.52[1] (plus additional damage sustained after February 28, 1978) plus interest and costs for Steel's alleged breach of its express and implied obligations under the participation agreements. The Bank, as a third-party beneficiary and as assignee of the third-party beneficiary Trust, also requested judgment on this Count for damages in an unspecified amount.

In Count II, the Mortgage Company sought the same amount of damages as under Count I plus $1,000,000 punitive damages for Steel's alleged interference with the Mortgage Company's contractual relationships with the Bank and Trust. The Bank on the same theory requested compensatory damages plus $3,000,000 punitive damages.

In Count III, the Bank, in its own right and as assignee of the Trust, requested actual damages plus punitive damages of $3,000,000 for Steel's alleged breaches of its duties to the Bank and Trust as co-participants in the financing of the project.[2]

On January 8, 1979, Steel filed an amended counterclaim against plaintiffs and an amended claim against counterdefendant American Fletcher Corporation (AFC),

---

[1] This sum represents the $293,962.83 due the Mortgage Company as of October 16, 1975, and the $160,216.69 due the Mortgage Company as of February 28, 1978. These amounts reflect Steel's 40% share of the disbursements by the Mortgage Company.

[2] A fourth count, alleging abuse of process, was dismissed by stipulation on January 31, 1980 (R. Vol. II at 382). The fourth count of Steel's amended counterclaim also alleged abuse of process and was dismissed by the same stipulation.

the parent corporation of the plaintiffs. In Count I of this pleading, Steel alleged that on October 1, 1973, the Mortgage Company forwarded to Steel participation offerings in loans for the acquisition and construction of the condominium project in Cromwell, Connecticut. In this pleading Steel described the participation offerings as securities as defined in Section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. § 78(a)(10)) and in Section 2(1) of the Securities Act of 1933 (15 U.S.C. § 77(b)(1)). Steel accepted these "Security Offerings" on October 27, 1973, by executing and sending the Mortgage Company two participation agreements. Both participation agreements were executed by the Mortgage Company and dated December 31, 1973.

Steel asserted that its acceptance was conditioned upon the understanding that the Mortgage Company would not close the Cromwell loans or call upon Steel to make disbursements until Justin had complied with all conditions precedent under the loan agreements. According to Steel, the Mortgage Company closed the loans even though Justin had not satisfied the conditions precedent. Steel claims that it was therefore not bound to advance any monies on the Cromwell loans and that its advances in response to the Mortgage Company's draw requests constituted an investment in securities governed by Section 10b of the Securities Exchange Act (15 U.S.C. § 78j(b)), S.E.C. Rule 10b-5 (17 C.F.R. § 240.10(b)-5) and Section 17 of the Securities Act (15 U.S.C. § 77q).

Steel further alleged that at the time the participation agreements were entered into and during the period prior to mid-June 1975, the Mortgage Company had misrepresented certain material facts and omitted to disclose certain other facts in violation of Section 10b of the 1934 Act, S.E.C. Rule 10b-5 and Section 17 of the 1933 Act, causing Steel to advance $2,306,448.07 to the Mortgage Company pursuant to the agreements. In Count I Steel accordingly sought that amount in damages plus prejudgment interest and costs.

Counts V-VIII asserted securities claims in the same amount against the Bank and AFC as "controlling persons" and aiders, and abettors of the Mortgage Company's alleged securities law violations.[3] By a second amendment on April 10, 1979, Steel added Counts IX-XI, alleging similar violations of the Indiana "Blue Sky" law (§§ 23-2-1-12 and 23-2-1-19(a) of the Indiana Code).

On March 20, 1980, the district court denied Steel's motion for partial summary judgment on Counts I, II and III of the amended and supplemental complaint and subsequently issued a certificate for interlocutory appeal under 28 U.S.C. § 1291(b). On April 24, we granted leave to appeal, and that portion of the case was docketed here as No. 80-1719.

On March 21, 1980, the district court granted plaintiffs motion to dismiss or for judgment on the pleadings on the securities fraud counts (Counts I, V-XI) of Steel's amended counterclaim. This final judgment was based on Judge Steckler's conclusion that the loan participation interests were not securities within the meaning of the federal and state securities laws. At the same time, in an interlocutory ruling, Steel's cross-motion for summary judgment declaring the loan participations to be securities was denied as moot by reason of the holding on the motion to dismiss. Steel's appeal from the dismissal of its securities claims was docketed here as No. 80-1485. Leave to appeal the denial of summary judgment to Steel on the "securities" issue was granted in our April 24 order, and that appeal was therefore docketed with the other interlocutory appeal under No. 80-1719.

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[3] Counts II and III, alleging common law fraud and breach of contract, are not in issue here. Count IV, alleging abuse of process, was dismissed by stipulation. See note 2 *supra*.

II. *Denial of Partial Summary Judgment on Plaintiffs' Claims Was Appropriate.*

A. *Count I of Amended and Supplemental Complaint*

As noted above, the Mortgage Company and the Bank, as a third-party beneficiary and assignee of the third-party beneficiary Trust, sued in Count I on a breach of contract theory. Steel moved for summary judgment with respect to the Bank on the argument that the Bank and Trust were not third-party beneficiaries of its participation agreement with the Mortgage Company.[4] Judge Steckler held that there was a genuine issue of fact as to whether the participation agreements were intended to benefit the Bank and Trust and therefore denied the motion (Steel App. 8-9). Steel contends this holding was erroneous because an intent to benefit the Bank and Trust does not "affirmatively appear from the language of the document" as required by Indiana law. We disagree.

The contractual obligation on which the Bank and Trust predicate their claims is "Steel's duty to cooperate in efforts to protect the project and minimize loss—and the concomitant duty not to submarine the project to further its own hand" (Plaintiffs' Br. 41). They rely on the clause in the participation agreements requiring Steel to *reimburse* the Mortgage Company for all extraordinary out-of-pocket costs and expenses incurred "for the protection and preservation of security, for the minimizing of loss * * *" (Steel App. 104, 106). In addition, there is, of course, an implied covenant of good faith and fair dealing by Steel. *Photovest Corp.* v. *Fotomat Corp.*, 606 F.2d 704, 727-729 (7th Cir. 1979), certiorari denied, 445

[4] Steel suggests in its reply brief that it is entitled to summary judgment against the Bank individually and as assignee of the Trust as to plaintiffs' Counts I, II and III because Steel had repudiated the participation agreements (Reply Br. 16-17). Since *this argument was not made below* nor indeed in Steel's principal brief here, we will not consider it.

U.S. 917; *Lesh* v. *Trustees of Purdue University,* 124 Ind. App. 422, 116 N.E.2d 117, 120 (1953); Indiana Code § 26-1-1-203; 5 Williston on Contracts § 670, p. 159 (3d. ed. 1961).

The Bank and Trust had a combined participation interest of 60% in the Cromwell project and stood to incur 60% of the losses. The participation agreements between Steel and the Mortgage Company expressly state that this 60% interest belonged to the Bank and Trust, not the Mortgage Company (Steel App. 103, 105). Thus Steel's obligation to minimize loss would "necessarily and within the contemplation of the parties result in a direct benefit to" the Bank and Trust. *Jackman Cigar Mfg. Co.* v. *John Berger & Son Co.,* 114 Ind.App. 437, 52 N.E.2d 363, 367-368 (1944). Indeed, as plaintiffs point out, it is difficult to see whom the minimization of loss clause was intended to benefit if not the three riskbearers.

For the foregoing reasons, we cannot agree with Steel that any benefit flowing from the contracts to the Bank and Trust was as a matter of law merely incidental. At best from Steel's viewpoint, the contract is ambiguous as Judge Steckler concluded, and therefore the question whether the contractual langauge in the circumstances of the transaction evidences an intent to benefit the Trust and Bank is an appropriate one for trial. See *Jackman Cigar Mfg. Co.* v. *John Berger & Son Co., supra; Standard Land Corp. of Indiana* v. *Bogardus,* 154 Ind.App. 283, 289 N.E.2d 803, 824-825 (1972); *Shahan* v. *Brinegar,* ..... Ind. App. ....., 390 N.E.2d 1036, 1041 (1979). Furthermore, we agree with plaintiffs that what is at issue here is the question who are the real parties-in-interest. If it is found at trial that the parties did not intend to benefit the Bank and Trust, that would not, of course, alter the Mortgage Company's capacity to sue in Count I for Steel's alleged breach of its duty of good faith. Rule 17(a), Fed. R. Civ. Pro.

B. *Count II of Amended and Supplemental Complaint*

In Count II plaintiffs assert that Steel through its dilatoriness interfered with the contractual relationships between the Mortgage Company, the Trust and the Bank,[5] justifying an award of compensatory and punitive damages to the Mortgage Company and the Bank in its own right and as assignee of the Trust. Steel moved for summary judgment on this Count with respect to the Bank and Trust, arguing that its alleged delaying tactics did not cause the Mortgage Company to breach any agreement with the Bank or Trust and that without an actual breach plaintiffs' claim will not lie under Indiana law.

Steel relies on the fact that the tort of "interference with contractual relationship by inducing a breach of contract" recognized by Indiana law requires an actual breach. The question before the district court, however, was whether "Indiana law recognizes the more loosely defined tort of tortious interference with contractual or business relations without an actual breach of contract" (Steel App. 9).

Since Indiana case law apparently gives no definitive answer to this question, Judge Steckler properly proceeded to attempt to determine how the Indiana courts would decide the question if confronted with it. In concluding that the Indiana courts would recognize such a tort, he relied on *Spier* v. *Home Insurance Co.*, 404 F.2d 896, 898 (7th Cir. 1968); *Martin* v. *Platt*, ... Ind.App. ....., 386 N.E.2d 1026, 1027 (1979); and *Gibson* v. *Miami Valley Milk Producers, Inc.*, 157 Ind.App. 179, 299 N.E.2d 631 (1973), all of which lend support to his position.[6] He also observed that the commentators recognize the broader tort. *E.g.*, Restatement (Second) of Torts § 766A (1979)

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[5] The contracts in question are the Mortgage Company's participation agreements with the Bank and Trust and its management agreement with the Trust.

[6] See also *Helvey* v. *O'Neill*, 153 Ind.App. 635, 288 N.E. 2d 553, 560-561 (1972).

and Comment c thereto; Prosser, *Law of Torts* § 129 (4th ed. 1971).

Steel cites no authority to the contrary. *Kiyose* v. *Trustees of Indiana University,* 166 Ind.App. 34, 333 N.E.2d 886 (1975), and *Martin* v. *Platt, supra,* on which Steel principally relies, stand for the proposition that only a third party, and not a party to the underlying contract, may be liable for tortious interference. Count II does not, however, allege interference with the contract between the Mortgage Company and Steel. With respect to the contracts between the Mortgage Company and the Bank and Trust, Steel is a third party. Since we find no reason to disagree with Judge Steckler's conclusion that a claim for tortious interference without an actual breach of contract would be recognized under Indiana law, we affirm his denial of Steel's motion with respect to Count II.

C. *Count III of Amended and Supplemental Complaint*

In Count III, the Bank, again in its own right and as assignee of the Trust, is seeking actual damages according to proof and punitive damages of $3,000,000 based on Steel's alleged breach of its obligations as a co-loan participant to the other participants. Steel's objection to this Count is that it had no legal relationship to the Bank or Trust and therefore no legal obligations to them. Judge Steckler refused to grant summary judgment for Steel on the ground that "if plaintiffs can substantially substantiate their third-party claim, a contractual relationship giving rise to the duty to act in good faith toward each other would exist" (Steel App. 11). Since Steel concedes the district court's point (Br. 59), its argument here must be taken as an extension of the argument we rejected with respect to Count I, namely, that the Bank and Trust are as a matter of law not third-party beneficiaries of the agreement between the Mortgage Company and Steel.

The Bank further argues in support of the district court's ruling that the three participants became real es-

tate developers when the Mortgage Company acquired title to the Cromwell project in settlement with the borrower. Steel's dilatoriness in 1976, 1977 and 1978 is relied upon to show that the Bank and Trust sustained damages equal to 60% of the difference between the project's April 1978 value "and the value it would have had if the Mortgage Company had been able to implement its proposals to move forward with and/or dispose of the project" (Steel App. 99). Indiana law has long recognized the duty of a party engaged in a common enterprise to act in the utmost good faith toward its co-venturers. *Grover* v. *Marott*, 192 Ind. 552, 136 N.E. 81, 85 (1922). For this reason and that stated by Judge Steckler, the district court properly denied Steel's motion for partial summary judgment with respect to Count III.

Accordingly, we affirm the district court's order of March 20 in its entirety.[7] Our ruling does not mean, of course, that Steel may not prevail on any or all of the three Counts after trial.

III. *The Loan Participants Are Not Securities.*

In its March 21 order, the district court, finding that Steel's participation in the loans to Justin did not constitute the purchase of a "security" within the meaning of the federal and Indiana securities laws, granted plaintiffs' motion to dismiss or for judgment on the pleadings on the securities fraud counts of Steel's amended counterclaim against the Mortgage Company and the Bank and Steel's amended claim against AFC. It therefore denied as moot Steel's cross-motion for a summary judgment declaring the loan participations to be securities.

It is undisputed that for the purposes of this appeal the term "security" is the same under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Indiana "Blue Sky" Act. "Unless the context otherwise re-

[7] This appeal does not question the district court's denial of Steel's motion to strike paragraphs 7, 12 and 13 of the amended and supplemental complaint.

quires," these laws apply to "any note * * * or participation in any profit-sharing agreement * * *." 15 U.S.C. §§ 77b(1) and 78c(a)(10); Indiana Code § 23-2-1-1(k). Because of the qualifying phrase, literal inclusion in the statutory list of potential securities is not the test for a "security." Whether a security is involved or not depends upon the economic realities of the transaction in light of Congressional intent. *United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837, 848, 849; *Canadian Imperial Bank of Commerce Trust Co.* v. *Fingland,* 615 F.2d 465, 469 (7th Cir. 1980).

Steel appears to concede that the notes from Justin were not themselves securities (Br. 20-30). That concession conforms to our decision in *C.N.S. Enterprises Inc.* v. *G & G Enterprises, Inc.,* 508 F.2d 1354 (7th Cir. 1975), certiorari denied, 423 U.S. 825. In turn, the Mortgage Company and the Bank concede that a participation may be a security even though the underlying note is not (Br. 8 n.3). Therefore, the sole issue here is whether Steel's loan participation was a security under the quadruple test developed by the case law for determining the existence of a security. A brief look at the transaction here in light of that test makes clear that the loan participations were not securities.

Under *Forman, supra,* four elements are required for a security: (1) an investment, (2) in a common venture, (3) premised upon a reasonable expectation of profits, (4) to be derived from the entrepreneurial or managerial efforts of others. 421 U.S. at 852; see also *S.E.C.* v. *W. J. Howey,* 328 U.S. 293, 301. Here the only element present is a common venture, and that alone is insufficient.

The documents executed by the Mortgage Company and Steel recite that the Mortgage Company is the holder of loan obligations evidenced by promissory notes, indicating that this was a collateralized commercial loan with the return to Steel to be in the form of repayment of principal plus interest. Steel itself drafted the participation agreements, which were on typical lenders' forms, and the loan

officer for Steel who prepared the loan proposal based his recommendation that the loans be made on the existence of a first mortgage on the property and improvements, *the Bank's recommendation* concerningthe borrower, and the personal guarantees of Justin's principals (Plaintiffs' App. 3). Borrowing for a *designated purpose* (here the Justin project) and a short note maturity, here three years, are indicia of a commercial loan rather than an investment. *C.N.S. Enterprises, supra,* 508 F.2d at 1361. To be sure, the loan was risky, but the risk taken was "the ordinary commercial risk taken by any secured lender," not an investment risk. *Lincoln National Bank* v. *Herber,* 604 F.2d 1038, 1043 (7th Cir. 1979).

The fact that the loan bore interest does not make it a security. *Canadian Imperial Bank of Commerce Trust Co.* v. *Fingland, supra,* 615 F.2d at 470; *C.N.S. Enterprises, Inc.* v. *G & G Enterprises, Inc., supra,* 508 F.2d at 1359. Steel was not to participate in any of the profits from the Justin project, and neither the repayment of the loan nor the *rate* of return was in any way dependent on the actual profits, if any, of the project. Instead, it was fixed at a specific rate above prime. In short, this is not an investment premised upon a reasonable expectation of profits but rather a commercial real estate loan transaction.

This Court recently held that *Congress did not intend to regulate commercial loan transactions that would have no impact on the securities markets. Lincoln Nebraska Bank, supra,* 604 F.2d at 1042. Thus in the absence of an investment transaction or impact on the securities market, the term "security" is not applicable to commercial loans including the one in issue here. See *Emisco Industries, Inc.* v. *Pro's Inc.,* 543 F.2d 38, 39 (7th Cir. 1976); *National Bank of Commerce* v. *All American Assurance Co.,* 583 F.2d 1295, 1301 (5th Cir. 1978). The cases that Steel relies on to the contrary are those in which courts in *the Second Circuit found securities*

because of the literal language of the statutes.[8] The literal language approach has been rejected by the Supreme Court as well as this Court. *Forman, supra,* 421 U.S. at 848, 849 n. 14; *C.N.S. Enterprises, supra.*

Steel's reliance on its lead lender, the Mortgage Company, for credit evaluations and day-to-day monitoring of the loan does not, as Steel argues, convert its loan participations into securities. Steel in fact conducted its own investigations of the project, and the extent of its control over management of the loan belies its suggestion that it was dependent on the Mortgage Company's entrepreneurial efforts in this venture. Steel retained the rights of a lender to demand foreclosure, preclude substitution or release of collateral, prevent modification of terms of loan obligation, and so on. *In any event, Steel's decision to enter the participation agreement was based on its own business judgment,* and as already noted, the loan was collateralized and guaranteed by the principals of the development corporation. The interest on the loan did not derive from the Mortgage Company's

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[8] See *Commercial Discount Corp.* v. *Lincoln First Commercial Corp.* 445 F.Supp. 1263 (S.D. N.Y. 1978) and *NBI Mortgage Investment Corp.* v. *Chemical Bank* [1976-1977] Fed. Sec. L. Rep. (CCH) ¶95,632 (S.D. N.Y. 1976) and [1977-1978] Fed. Sec. L. Rep. (CCH) ¶96,066 (S.D. N.Y. 1977), both following the literal language approach of *Exchange Nat'l Bank* v. *Touche Ross & Co.,* 544 F.2d 1126 (2d Cir. 1976). Steel also relies on *Lehigh Valley Trust Co.* v. *Central Nat'l Bank of Jacksonville,* 409 F.2d 989 (5th Cir. 1969). But see *National Bank of Commerce* v. *All American Assurance Co., supra,* 583 F.2d at 1300-1301; *Bellah* v. *First National Bank of Hereford,* 495 F.2d 1109, 1111-1116 (5th Cir. 1974); *McClure* v. *First Nat'l Bank of Lubbock,* 497 F.2d 490, 492-495 (5th Cir. 1974), certiorari denied, 420 U.S. 930, which abandon the literal approach. See also *Morsey* v. *Green* (S.D. Fla. No. 76-8044 CA, decided March 28, 1978), affirmed without opinion, 615 F.2d 917 (5th Cir. 1980), certiorari denied, 49 LW 3270, summarized, 49 LW 3267.

entrepreneurial services within the meaning of *Forman* but from the underlying notes.

Accordingly, we hold that Judge Steckler did not err in holding that the Mortgage Company, the Bank and AFC were entitled to dismissal or judgment on the pleadings as to Counts I and V-XI of the final Steel counterclaim and in denying Steel's cross-motion for summary judgment on the ground that its participation interests were not securities within the meaning of the federal and Indiana Acts.

The orders of March 20 and 21, 1980, are affirmed. Steel's motion for reassignment of trial judge is denied. A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
AND AMERICAN FLETCHER CORPORATION,
Counterdefendants.

IP 76-276-C

ORDER

This matter is before the Court on the motion of counterdefendants American Fletcher Mortgage Corporation ("AFMC"), American Fletcher National Bank ("AFNB"), and American Fletcher Corporation ("AFC") to dismiss or for judgment on the pleadings on certain counts of the amended counterclaim of United States Steel Credit Corporation ("Steel"). Also before the Court is Steel's cross-motion for a partial summary judgment on a narrow issue involved in those counts.

The factual background of this lawsuit is as follows. AFMC, as "lead lender" entered into loan participation agreement with Steel, AFNB, and American Fletcher Mortgage Investors ("Trust"). Steel was a 40% participant, AFNB a 10% participant, and Trust a 50% participant. When the condominium project to be financed by the loans ran into difficulties in 1975, AFMC, as lead

lender, attempted to salvage the project in several ways. Steel, apparently not wanting to inject any more money into the troubled project refused to go along with proposals agreed to by AFMC, AFNB, and Trust. Finally the project was sold "as is" allegedly at a far lower price than could have been obtained had Steel co-operated with the other parties, giving rise to AFNB and AFMC's claims against Steel. Steel's counterclaim, among other things, alleges that its interest under the loan participation agreement was a security, as defined in federal and state statutes, and that it was defrauded in the purchase of the securities by AFMC, AFNB, and AFC.

The counterdefendants have moved to dismiss or for judgment on the pleadings on Counts I, V, VI, VII, and VIII of the amended counterclaim, all of which allege violations of federal securities laws, and Counts IX, X, and XI of the second amendment to the amended counterclaim, which allege violations of state securities laws. The counterdefendants contend that all of these counts must fail because, as a matter of law, the participation by Steel in loans made to the borrower did not constitute the purchase of a security within the meaning of federal and state statutes. Basically the counterdefendants' argument is that the participation interests did not possess the required elements necessary to make them securities as defined by the Supreme Court in *S.E.C.* v. *W. J. Howey*, 328 U.S. 293 (1946), and refined in *United Housing Foundation* v. *Forman*, 421 U.S. 837 (1974). "The touchstone [of all of the court's decisions defining a security] is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *Id.* at 852. In the counterdefendants' view,

since this was a commercial loan, it was not an "investment," since the return to Steel was to be in the form of interest payments on the loan, it was not "for profits," and since there was collateral for the loan which was administered by AFMC, there was no "reliance on the entrepreneurial or managerial efforts of others."

In opposition to counterdefendants' motion and in support of its own motion for summary judgment, Steel argues that its participation interests in the loans were securities and that all the elements of the *Howey-Forman* test were met. Steel contends that the principal issue is whether Steel procured these interests for investment purposes, in which case the interests are securities. Steel further maintains that the evidence is quite clear that it is in the business of investing, not lending, and that therefore a summary judgment declaring Steel's interests to be securities should be entered.

Since both parties agree on the basic elements of the test to be applied, the issue confronting the Court on this motion is whether or not Steel's interest was (1) an investment (2) in a common venture (3) premised on a reasonable expectation of profits (4) from the entrepreneurial or managerial efforts of others. The analysis of the elements of the above-stated test in the case of *FBS Financial* v. *CleveTrust Realty Investors, et al.*, [1978] Fed. Sec. L. Rep. (CCH) ¶ 96,341 (N.D. Ohio 1977), appears to this Court to be a well-reasoned, step-by-step approach in line with admonitions of the Supreme Court and the Seventh Circuit to avoid literalism and to examine and consider each case on its own facts in light of economic realities. *United Housing Foundation* v. *Forman* 421 U.S. 837, 849 (1974); *C.N.S. Enterprises,*

Inc. v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1362 (7th Cir. 1975). [Seventh Circuit cited favorably a similar list of factors for analysis at 1361.]

In the first phase of the *FBS* analysis, several factors are examined to determine the status of the "investment" element. These include (1) the name given the transaction by the parties, (2) the subjection of money to risk, considering particularly the length of the term, (2) the existence of collateral, (4) the existence of a "take-out lender" to buy out the participants' interests, and (5) the contemplated and actual use of the funds.

Examining these factors, the Court notes first that the documents executed by AFMC and Steel recite that AFMC is the holder of loan obligations evidenced by promissory notes. The parties then agree that AFMC "hereby sells . . . unto [Steel] . . . a ratable participating share of Forty Per Cent . . . in and to said note[s], and all proceeds and avails of said note[s] and the security therefore. . . ." Thus, the agreement refers to the loans and notes, which lends support to counterdefendants' position. On the other hand, it also refers to the purchase of a "share." However, labeling an interest a "share" is not dispositive, as can be seen from the ruling in *Forman, supra.* In deposition testimony various Steel employees refer to both "loans" and "investments." Thus it cannot be said that the parties' characterization of the interests is persuasive evidence of either interpretation.

Dealing next with the factor of the subjection of money to risk and considering in particular the length of time involved, the Court notes first, as have other courts, *see, C.N.S. Enterprises, supra*; *FBS Financial, supra*, at 93, 156, that although subjection of money to the risk

of continued business operations is characteristic of an investment and hence security status, this risk in and of itself is not dispositive of the question. The *FBS Financial* Court remarked that one way to distinguish a "risky loan" from "risk capital" is to determine the length of time the money is retained by the enterprise receiving it. The longer this period, the more the interest appears to be in investment. *FBS Financial,* at 93, 156. It appears that in this case the length of time the borrower was to retain the money was three years, which is considerably longer than the less than one year period involved in *FBS Financial.* Of course, since loans with three year and longer terms are made quite often, the three year term in this case cannot be dispositive of the question.

Turning next to the question of collateral, the Court notes that there was collateral for the loan, as well as sureties and the personal guarantees of individuals associated with the borrower. Although it does not appear that Steel had direct rights in the collateral, AFMC, as lead lender, could not release any security for the loans without the consent of Steel. Under similar circumstances, the Court in *Provident Nat. Bank* v. *Frankford Trust Co.,* 468 F. Supp. 448, 455 (E.D. Pa. 1979), found that it was unrealistic to suggest . . . that the loan participation itself was not . . . collateralized."

In *FBS Financial* the Court felt that the existence of a "take-out lender" who was to buy out the participant's interests in a relatively short period of time, thus guaranteeing a minimum return, was indicative of a loan. In the instant situation, nothing comparable to the take-out lender exists.

Concerning the question of the actual and contemplated use of the funds, it appears that the instant case differs

from *FBS Financial* in that in *FBS* the funds paid in by the sub-participant were used by the participant to meet current commitments rather than to obtain "investment assets" or new capital assets. Here it seems rather obvious that new capital assets were acquired with the funds. However, the Court recognizes that funds are constantly loaned for the purpose of purchasing new capital assets; therefore this factor is also not dispositive of the "investment versus loan" question.

Summarizing on the investment element of the *Howey-Forman* test, the Court feels that the evidence is rather evenly balanced between "security" and "loan."

Moving on now to the question of the existence of a reasonable expectation of profits, the Court finds that Steel could reasonably expect to receive repayment of principal and interest fixed at a certain percentage over prime. The *amount* of these payments had nothing to do with the profits or productivity of the enterprise financed. This is indicative of a loan. *FBS Finance, supra,* at 93, 159; *National Bank of Commerce of Dallas* v. *All American Assurance Co.,* 583 F.2d 1295 (5th Cir. 1978).

The final requirement of the *Howey-Forman* test of a security is that the profits are to be derived from the entrepreneurial or managerial efforts of others. The courts in both *FBS Financial, supra,* at 93, 159, and *Provident, supra,* at 455, found that the efforts of a "lead lender" in administering a loan were not managerial or entrepreneurial in the sense that they generate the return expected by the parties to the participation.

In summary, based upon the Court's conclusions on the "reasonable expectation of profits" issue and the "entrepreneurial and managerial efforts" issue, the Court finds

that the participation interests were not securities within the meaning of the federal and state securities laws. Accordingly, the motion of counterdefendants AFMC AFNB, and AFC to dismiss or for judgment on the pleadings on Counts I, V, VI, VII, and VIII of the amended counterclaim and Counts IX, X, and XI of the second amendment to the amended counterclaim is GRANTED. The cross-motion of defendant-counterclaimant Steel for a summary judgment declaring the loan participation interests to be securities is MOOT by reason of the Court's ruling on counterdefendants' motion.

IT IS SO ORDERED.

Dated this 21st day of March, 1980.

/s/ William E. Steckler
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
AND AMERICAN FLETCHER CORPORATION,
Counterdefendants.

Cause No. IP 76-276-C

AMENDMENT OF MARCH 21, 1980 ORDERS, ADDING RULE 54(b) CERTIFICATE AND CERTIFICATE FOR INTERLOCUTORY APPEAL, AND STAYING FURTHER PROCEEDINGS PENDING APPEAL

This cause came on before the Court upon the Motion of Counterclaimant, U. S. Steel Credit Corporation ("Steel") for a Rule 54(b), F.R.Civ.P., certification of the Court's Order dated March 21, 1980, granting Counterdefendants' motion to dismiss or for judgment on the pleadings on federal and state "securities" fraud counts of Steel's counterclaim (Counts I, V, VI, VII, VIII, IX, X and XI), and upon Steel's further motion for a stay of proceedings in this cause, pending appeal of final judgment on such March 21, 1980, Order.

And the Court, having examined Steel's Motion and supporting Brief, having discussed the matter informally

with counsel for all parties, and being fully advised in the premises, NOW FINDS that Steel's Motion should be granted.

As to this Court's ruling which denies Steel's cross-motion for a partial summary judgment declaring Steel's loan participations to be "securities" within the meaning of the federal and state securities acts, the Court further finds that the issues presented by such cross-motion meet the three tests for interlocutory appeal pursuant to 28 U.S.C. §1292(b), and should be certified for interlocutory appeal, so that all rulings of this Court under its Order of March 21, 1980, may be considered together on appeal to the United States Court of Appeals for the Seventh Circuit.

It is, therefore, ORDERED, ADJUDGED AND DECREED that this Court's Order of March 21, 1980, is hereby amended by the addition of the following paragraphs:

Pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, this Court has determined and now certifies that there is no just reason for delay, and hereby directs the entry of final judgment on the order granting Counterdefendants' Motion to Dismiss or for Judgment on the Pleadings on Counts I, V, VI, VII, VIII, IX, X and XI of Steel's Counterclaim, as amended.

As regards this Court's Order denying Steel's cross-motion for summary judgment on the question of whether or not Steel's participations were "securities" as defined in the Federal Securities Act of 1933 [15 U.S.C. §77(b)(1)], the Securities Exchange Act of 1934 [15 U.S.C. §78(c)(A)(10) and the Securities Act of Indiana (I.C. §23-2-1-(k)], it is the opinion of this Court that, within

the meaning of 28 U.S.C. §1292(b), such question involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of this litigation.

Further proceedings in this litigation in this Court are hereby stayed, pending the outcome of appeal of the rulings and issues certified in this Order, as amended.

Dated this 28th day of March, 1980.

/ William E. Steckler
William E. Steckler
Judge

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Opinion by Judge Cummings
JUDGMENT — ORAL ARGUMENT

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604
November 3, 1980

Before

Hon. WALTER J. CUMMINGS, *Circuit Judge*
Hon. HARLINGTON WOOD, JR., *Circuit Judge*
Hon. WILLIAM J. CAMPBELL, *Senior District Judge*•

Nos. 80-1485 and 80-1719

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION, a Delaware Corporation,
Defendant and Counterclaimant-Appellant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
AND AMERICAN FLETCHER CORPORATION,
Counter-Defendants-Appellees.

Appeals from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. IP 76-C-276
WILLIAIM E. STECKLER, *Judge.*

This cause was heard on the record from the United States District Court for the Southern District of Indiana, Indianapolis Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby AFFIRMED, with costs, in accordance with the opinion of this court filed this date.

• The Honorable William J. Campbell, Senior District Judge of the Northern District of Illinois, is sitting by designation.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604
December 3, 1980
Before

Hon. WALTER J. CUMMINGS, *Circuit Judge*
Hon. HARLINGTON WOOD, JR., *Circuit Judge*
Hon. WILLIAM J. CAMPBELL, *Senior District Judge**

Nos. 80-1485 and 80-1719

AMERICAN FLETCHER MORTGAGE COMPANY, INC., et al.,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION,
Defendant-Counterclaimant (Appellant),

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., et al.,
Counterdefendants (Appellees).

Appeals from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. IP 76-276-C
WILLIAM E. STECKLER, *Judge.*

ORDER

On consideration of the petition for rehearing and suggestion for rehearing *en banc* filed in the above-entitled cause by appellant U. S. Steel Credit Corporation, no judge in active service has requested a vote thereon, and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby DENIED.

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* The Honorable William J. Campbell, Senior District Judge of the Northern District of Illinois, is sitting by designation.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY, AND AMERICAN FLETCHER CORPORATION,
Counterdefendants.

Cause No. IP 76-276-C

U. S. STEEL CREDIT CORPORATION'S AMENDED COUNTERCLAIM AND AMENDED CLAIM AGAINST COUNTER-DEFENDANT

For its Amended Counterclaim against Plaintiffs and Amended Claim against Counte-Defendant, American Fletcher Corporation, Defendant, U. S. Steel Credit Corporation, states the following:

Count I

Securities Act Violations by AFMC

For First Count of its Amended Counterclaim and Amended Claim, U. S. Steel Credit Corporation ("Credit Corporation") says:

1. This Court has jurisdiction of this Court under 28 U.S.C. §1331, since the instant claim arises under the laws of the United States and the matter in controversy

exceeds the sum of $10,000.00, exclusive of interest and costs. 15 U.S.C. §78aa also confers jurisdiction.

2. On or about October 1, 1973, Plaintiff, American Fletcher Mortgage Company ("AFMC"), from its offices in Indianapolis, Indiana, forwarded by United States mail to Credit Corporation at its offices in New York, New York, Participation Offerings in loans for the acquisition and development and construction of a condominium project in Cromwell, Connecticut ("The Project"). Copies of the said Participation Offerings are hereto attached and made a part hereof as Exhibits "A" and "B", respectively.

3. The said Participation Offerings (hereinafter called "The Security Offerings") constituted offerings of securities, as defined in §3(a)(10) of the Securities Exchange Act of 1934, as amended [15 U.S.C. §78(a)(10)] and §2(1) of the Securities Act of 1933, as amended [15 U.S.C. §77(b)(1)].

4. On or about October 27, 1973, Credit Corporation executed and forwarded by United States mail from New York City to Indianapolis proposed participation agreements ("The Participation Agreements"), indicating Credit Corporation's acceptance of AFMC's Security Offerings. Copies of the Participation Agreements are hereto attached and made a part hereof as Exhibits "C" and "D", respectively.

5. The Participation Agreements were subsequently executed by AFMC on a date unknown to Credit Corporation. The date inserted in both Participation Agreements by AFMC was December 31, 1973.

6. Credit Corporation's acceptance of the Security Offerings, as evidenced by its execution of the Partici-

pation Agreements, was conditioned upon the understanding that AFMC would not close the Cromwell loans, or call upon Credit Corporation to make disbursements thereunder, unless and until the borrower, Justin Development Corporation ("Justin") had complied with all conditions precedent required of Justin under the Loan Agreements, which were incorporated by reference in the Participation Agreements. Among other conditions precedent, the Building Loan Agreement (copy of which is hereto attached and made a part hereof as Exhibit "E") required Justin to submit to AFMC and secure AFMC's approval of (a) the General Contract for Construction of the Project, and (b) Performance and Labor and Material Payments Bonds.

7. Despite the fact that Justin satisfied none of the foregoing conditions precedent, AFMC closed the Loans and, for a period of sixteen months between the date of closing the Construction Loan in February, 1974, and mid-June, 1975, made disbursements thereunder, exacting from Credit Corporation its share of each of such disbursements, without either compelling compliance by Justin or disclosing to Credit Corporation the fact of Justin's non-compliance.

8. During said sixteen months period, wherein, by reason of Justin's continued failure to meet conditions precedent, neither Credit Corporation, nor any of the other participants or lenders, was legally bound to advance any monies on the Cromwell loans, each of Credit Corporation's advances in response to AFMC's periodic draw requests represented an investment in securities, governed by §10(b) of the Securities Exchange Act of 1934 [15 U.S.C. §78j(b)] and Securities Exchange Com-

mission Rule 10(b)-5 [17 C.F.R. §240.10(b)-5] and by §17 of the Securities Act of 1933 [15 U.S.C. §77q].

9. On or before the final execution of the Participation Agreements, and at various times thereafter during the period prior to mid-June, 1975, AFMC knowingly, deliberately and with intent to deceive, or with reckless disregard for the obviously deceptive consequences of its conduct, and in order to induce Credit Corporation to make its initial investment commitment, and to continue investing in AFMC's Security Offerings and to prevent Credit Corporation from revoking its investment commitment and discontinuing investments in such Security Offerings, AFMC misrepresented certain material facts to Credit Corporation, and omitted to disclose to Credit Corporation certain other material facts, including (but not limited to) the following:

(a) AFMC misrepresented to Credit Corporation its intentions with respect to loaning funds for interest and finance charges on The Project. Its cost breakdown on the Land Acquisition & Development Loan ("L & D Loan") indicated the sum of $250,000.00 allocated to interest and financing charges, which led Credit Corporation to believe that this amount was budgeted for the L & D Loan only. In fact, AFMC intended the $250,000.00 to cover interest and finance charges on both loans, for which purpose the said sum was hopelessly inadequate.

(b) AFMC failed to disclose to Credit Corporation that the personal guarantors of the Cromwell Loans were also personal guarantors of two other loans to Justin in the aggregate sum of more than $7,700,000.00 for the acquisition, development and construction of a different condominium project at Brandford, Connecticut, which was in progress at the same time as the Cromwell Project.

(c) AFMC failed to disclose that the same borrower (Justin), the same general contractor (Jobco, Inc.) and (with the exception of Credit Corporation) largely the same participating lenders, involved in the Cromwell Project, were also involved in the Branford Project, which created the risk of diversion of Cromwell Loan Funds to Branford.

(d) AFMC misrepresented to Credit Corporation that 450 condominium units were to be developed and constructed at Cromwell, whereas it was apparent from the master construction contract, entered into in May, 1973, and from the Site Plan, that Justin and Jobco proposed to develop and build only 400 condominium units, and the zoning laws at Cromwell limited to 400 the maximum number of condominium units of the size and area contemplated by the parties, which could lawfully be constructed on the Cromwell site.

(e) AFMC failed to disclose to Credit Corporation that it closed and made disbursements on both of the Cromwell Loans without obtaining from Justin a proper site plan.

(f) AFMC failed to disclose to Credit Corporation the long continued failure of Justin to furnish a proper Construction Contract and a proper Performance and Payment Bond as recited in rhetorical paragraphs 6 and 7, above.

(g) AFMC failed to disclose to Credit Corporation that the first phase construction contract, initially entered between Justin and Jobco, called for construction of only 100 condominium units, whereas the Building Loan Agreement required 150 units to be constructed in the first phase. AFMC further failed to disclose to Credit Corporation that when in response to AFMC's objection to the 100 unit contract a new first phase contract for 150 units was prepared and

signed by Jobco, Justin failed to execute it, and though repeatedly requested to do so, could not be persuaded to sign the 150 unit contract until sixteen months thereafter.

(h) AFMC failed to disclose to Credit Corporation that in January, 1975, it discovered, upon examination of a proposed form of bond rider received from the Bonding Company, that Justin and Jobco had surreptitiously amended the price clause of the construction contract without consulting or advising AFMC. AFMC further failed to disclose that its efforts to obtain a copy of the price clause amendment during the next six months proved unsuccessful, and that it executed the bond rider in mid-June, 1975, without deletion of the reference to the price clause amendment. In fact, the price clause amendment purported to convert the construction contract from a fixed price contract to a cost plus 10% contract.

(i) AFMC failed to disclose to Credit Corporation that prior to the closing of the Cromwell Construction Loan, its legal counsel in charge of closing the Loan had warned that the Loan was inadequate to complete development and construction of the first phase of the Project. It became clear to AFMC in late 1974, that the Loans were inadequate to complete the first phase. Yet, in January of 1975, at a time when AFMC was working on a proposal to increase the Cromwell Loans, AFMC falsely represented to Credit Corporation that the Loans were "in balance and on track".

(j) AFMC induced Credit Corporation to consent to the release of the personal guaranty of Jobco's president on the ground that such release was necessary in order to secure a performance bond on Jobco. Credit Corporation agreed to release Jobco's president on the express condition that a proper performance bond be obtained. AFMC

then proceeded to release Jobco's president from his personal guaranty without having obtained a proper performance bond, and then concealed from Credit Corporation the fact that it had done so.

(k) AFMC failed to disclose to Credit Corporation that Justin had discharged its architect (who also was one of the pesronal guarantors) and had changed the Plans and Specifications for construction, without obtaining AFMC's approval.

(l) AFMC failed to disclose to Credit Corporation that, despite the absence in the cost breakdown of the Construction Loan of any provision for disbursement of funds needed to pay interest on that Loan, it was, nevertheless, advancing funds for the payment of interest on both the L & D Loan and the Construction Loan far in excess of the $250,000.00 budgeted in the L & D Loan for that purpose. It further failed to disclose to Credit Coporation that it was applying funds budgeted for one purpose under its cost breakdowns to other entirely different purposes, that it was indiscriminately diverting funds from the L & D Loan to the Construction Loans and vice-versa, and that as a result of these activities. both of the Cromwell Loans wee out of balance.

(m) In March, 1975, in an effort to induce Credit Corporation to agree to increasing the Cromwell Loans, AFMC represented to Credit Corporation that it had "full bonding" on the Cromwell Loans, when it knew that such was not the case.

(n) In order to obtain full bonding, the Bonding Company had stipulated, among other conditions, it must have the lender's assurance that the loan funds were sufficient to complete construction of the first phase of the Project in accordance with the Construction Contract. AFMC failed to disclose to Credit Corporation that it obtained the increased bond in mid-June, 1975,

by giving the Bonding Company the assurance it sought concerning the sufficiency of the loan funds, and that AFMC gave this assurance even though AFMC knew (i) that the existing loan was insufficient, (ii) that AFMC's commitment to increase the loan was conditioned upon approval of such increases by Credit Corporation and the other participants, and (iii) that Credit Corporation had neither approved nor given any assurance that it would approve an increased loan.

(o) Further instances of misrepresentations and non-disclosures on the part of AFMC in connection with the Cromwell Loans are enumerated in Credit Corporation's particularized Statement of Claims, paragraphs e and f of which, on pages 3-6, are incorporated herein as if set forth at length herein, except to the extent that such paragraphs are in substance duplicated herein.

10. All of the facts which AFMC misrepresented or failed to disclose as aforesaid, were "material facts", which, if promptly and accurately disclosed, would have had an important influence on the decision of any reasonable investor, including Credit Corporation to invest initially or to continue investing in the Cromwell Project.

11. Over the period, beginning with the closing of the Cromwell L & D Loan, in 1973, and ending prior to the time in mid-June, 1975, when AFMC first obtained Justin's signature on the Construction Contract for 150 condominium units, and obtained the increased performance bond, Credit Corporation, in detrimental reliance upon the assumed accuracy and completeness of AFMC's statements of material fact in connection with the Security Offerings, and without knowledge of the material misrepresentations and non-disclosures described above, advanced to AFMC, pursuant to the Participation Agreements, sums amounting in the aggregate to $2,063,448.47.

12. AFMC's conduct in misrepresenting and omitting material facts as aforesaid in connection with its Security Offerings were in violation of §10(b) of the Securities Exchange Act of 1934 and Rule 10(b)-5 promulgated thereunder, as well as §17 of the Securities Act of 1933.

13. As a proximate result of AFMC's violations of the above statutes and rule, Credit Corporation has been damaged in the sum of at least $2,063,448.47.

WHEREFORE, Credit Corporation prays for judgment in its favor and against AFMC as follows:

(1) That the Participation Agreements, attached as Exhibits "C" and "D", be rescinded;

(2) That the sum of $2,063,448.47, advanced by Credit Corporation pursuant to said Participation Agreements be returned to Credit Corporation as compensatory damages, together with such additional sums as the evidence shall justify and pre-judgment interest and costs;

(3) That Credit Corporation be awarded all other and further relief, which shall be proper in the premises.

Count V

AFNB's Securities Law Violations
As a "Controlling Person"

For Fifth Count of its Amended Counterclaim and Amended Claim and first count against American National Bank and Trust Company ("AFNB"), Credit Corporation says:

1.-13. Credit Corporation re alleges and incorporates herein as if set forth at length herein rhetorical paragraphs 1 through 13 of Count I of this pleading.

14. At all times material hereto AFNB has been engaged in a variety of financing activities and Credit Cor-

poration has been engaged in a variety of investing, financing and leasing activities.

15. By various means, including (but not limited to) placing its officers and employees in management positions with AFMC and on important committees, AFNB, at all times material hereto asserted actual control over AFMC, and was a "controlling person" as described in §20(a) of the Securities Exchange Act of 1934.

16. AFNB, in controlling the actions of AFMC, specified in rhetorical paragraphs 2 through 12 of Count I above, violated §10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10(b)-5 [17 C.F.R. §240.10 (b)-5], promulgated thereunder.

17. As a proximate result of AFNB's violation of said statute and rule, Credit Corporation has been damaged in the sum of at least $2,063,448.47, plus substantial additional damage in amounts not yet determined.

WHEREFORE, Credit Corporation prays for judgment in its favor and against AFNB on this Count V as follows:

(1) That Credit Corporation be awarded compensatory damages in such amount, not less than $2,063,448.47, as the evidence shall justify, together with pre-judgment interest and costs;

(2) That Credit Corporation be awarded such other and further relief as shall be proper in the premises.

Count VI

AFNB's Liability for Aiding and Abetting AFMC

For Sixth Count of its Amended Counterclaim and Amended Claim, and for its second count against American Fletcher National Bank and Trust Company, ("AFNB"), Credit Corporation says:

1. Credit Corporation re-asserts and incorporates as if set forth in length herein the allegations of rhetorical paragraphs 1 through 12 of Count I above.

2. Through various AFNB personnel, who were posted in key management positions with AFMC and on important committees of AFMC, AFNB kept itself fully informed of all of the material facts concerning the Cromwell loans and has knowledge that such material facts were either being misrepresented or concealed from Credit Corporation; yet AFNB took no corrective action.

3. As stated above and in other respects AFNB aided and abetted AFMC in its violations of §10(b) of the Securities Exchange Act of 1934 and Securities Exchange Commission Rule 10(b)-5 [17 C.F.R. §240.10(b)-(5)] and AFMC was, therefore, itself in violation of the said Act and Rule.

4. As a proximate result of AFMB's conduct in violation of said Statute and Rule, Credit Corporation has been damaged in the sum of at least $2,063,448.47, plus substantial additional damages in amounts not yet determined.

WHEREFORE, Credit Corporation prays for a judgment in its favor and against AFNB on this Count VI as follows:

(1) That Credit Corporation be awarded compensatory damages in such amount, not less than $2,063,448.47, as the evidence shall justify, together with pre-judgment interest and costs; and

(2) That Credit Corporation be awarded such other and further relief as shall be proper in the premises.

Count VII

AFC's Liability as a Controlling Person

For Seventh Count of its Amended Counterclaim and Amended Claim and for its First Count against Amer-

ican Fletcher Corporation ("AFC"), Credit Corporation says:

1.-13. Credit Corporation re-asserts and incorporates herein as if set forth at length herein, the averments of rhetorical paragraphs 1 through 13 of Count I above.

14. At all times material hereto, AFC has been engaged in a variety of financing activities and Credit Corporation has been engaged in a variety of investing, financing and leasing activities.

15. AFC is the parent corporation, which owns virtually all of the outstanding shares of AFMC and AFNB.

16. AFC has placed its own personnel in key management positions and on important committees of AFMC and has caused its subsidiary, AFNB to do likewise.

17. Through such ownership and control of AFMC and by so placing its own personnel and personnel of its subsidiary, AFNB, AFC has, at all times material hereto, exerted actual control over AFMC and was a "controlling person", as defined in §20(a) of the Securities Act of 1934, as amended [15 U.S.C. §78(t)].

18. AFC, in controlling the actions of AFMC, specified in rhetorical paragraphs 2 through 12 of Count I above, violated §10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10(b)-5 [17 C.F.R. §240.10(b)-5], promulgated thereunder.

19. As a proximate result of AFNB's violation of said Statute and Rule, Credit Corporation has been damaged in the sum of at least $2,063,448.47, plus substantial addi tional damage in amounts not yet determined.

WHEREFORE, Credit Corporation prays for a judgment in its favor and against AFC on this Count VII as follows:

(1) That Credit Corporation be awarded compensatory damages in such amount, not less than $2,063,448.47, as the evidence shall justify, together with pre-judgment interest and costs; and

(2) That Credit Corporation be awarded such other and further relief as shall be proper in the premises.

Count VIII

AFC's Liability for Aiding and Abetting AFMC

For Eighth Count of its Amended Counterclaim and Amended Claim and for Second Count against American Fletcher Corporation ("AFC"), Credit Corporation says:

1.-12. Credit Corporation re-asserts and incorporates herein as if set forth at length herein the allegations of rhetorical paragraphs 1 through 12, above, of Count I.

13. Through AFC personnel and various personnel of its subsidiary, AFNB, who were posted in key management positions and on important committees of AFMC, AFC kept itself fully informed of all of the material facts concerning the Cromwell loans, and had knowledge that such material facts were either being misrepresented or concealed from Credit Corporation; yet AFC took no corrective action.

14. As stated above and in other respects, AFC aided and abetted AFMC in its violations §10(b) of the Securities Exchange Act of 1934 and Securities Exchange Commission Rule 10(b)-5 [17 C.F.R. §240.10(b)-(5)] and AFC was, therefore, itself in violation of the said Act and Rule.

15. As a proximate result of AFC's conduct in violation of said Statute and Rule, Credit Corporation has been damaged in the sum of at least $2,063,448.47, plus substantial additional damages in amounts not yet determined.

WHEREFORE, Credit Corporation prays for a judgment in its favor and against AFC on this Count VIII as follows:

(1) That Credit Corporation be awarded compensatory damages in such amount, not less than $2,063,448.47, as the evidence shall justify, together with pre-judgment interest and costs; and

(2) That Credit Corporation be awarded such other and further relief as shall be proper in the premises.

/s/ William A. Wick
William A. Wick
/s/ Nicholas C. Nizamoff
Nicholas C. Nizamoff
Attorneys for U.S. Steel
Credit Corporation

White, Raub, Reis, Wick, & Riegner
1000 Merchants Bank Building
Indianapolis, IN 46204

EXHIBIT "A"

AMERICAN FLETCHER MORTGAGE COMPANY

A Subsidiary of American Fletcher Corporation
600 American Fletcher Building
Indianapolis, Indiana 46204
Tel. (317) 633-2443

PARTICIPATING OFFERING
TO
U. S. STEEL CREDIT CORPORATION

BORROWER:

Justin Development Corporation (See Remark #4)

LOCATION:

North Side of Route 72 near Interstate 91
Cromwell, Hartford County, Connecticut

TYPE OF LOAN:

Land Acquisition ($ 860,000.)
and Development ($1,670,000.)

TYPE OF PROPERTY:

To be developed for 450 condominium units.

LOAN AMOUNT:

$2,530,000. (76%)

APPRAISAL:

$3,240,000. (AFMC)

AMOUNT DISBURSED:

$1,315,300.

MATURITY:

Three (3) Years

PARTICIPATION OFFERED:

40%	($1,012,000.)	U. S. Steel Credit Corporation
50%	($1,265,000.)	American Fletcher Mortgage Investors
10%	($ 253,000.)	American Fletcher National Bank
	$2,530,000.	

ESTIMATED YIELD:

Five percent (5%) above AFNB base rate, adjusted as necessary.

REMARKS:

1. The land security consists of approximately 40 acres located on the north side of Route 72 near Interstate 91 in Cromwell, Hartford County, Connecticut. Cromwell lies twelve miles south of Hartford, Connecticut, and is considered a bedroom community for Hartford and New Haven.
2. Adjoining the site to the east is Cromwell Hills Condominiums, a 525-unit complex of which the first phase of 355 units has been offered in the market for a little less than two years. 330 of the units are sold and occupied. The subject is considered to be superior to the adjacent project because of unit size and square foot sales price and design.
3. The subject property is to be improved for a total of 450 condominium units, which will have average sales prices of $33,725. per unit. The instant land

acquisition and development loan will be repaid from unit sales at the rate of $7,500. per unit, which equates to complete repayment upon 75% of sales.

4. The borrower is the Justin Development Corporation of White Plains, New York. On April 12, 1973, the Executive Committee of AFMI approved a 50% participation along with a 10% participation approval from AFNB on the land acquisition and development. The principals of Justin Development Corporation are Mr. Michael S. Puntillo, with a net worth of $3,500,000.; Mr. Donald J. Colasono, net worth $941,400.; Mr. Gene L. Simms, net worth $1,105,000.; Mr. Robert A. Freeman, net worth $308,500.; Mr. Robert G. Schuermann, net worth $161,300. The total combined net worth is $6,016,-000. Each of the above individuals will personally guarantee the entire amount of this loan. Enclosed with this offering are personal statements and resumes on the individuals.
5. The development work on the subject site will have the protection of performance and labor and material payment bonds.

EXHIBIT "B"

AMERICAN FLETCHER MORTGAGE COMPANY

A Subsidiary of American Fletcher Corporation
600 American Fletcher Building
Indianapolis, Indiana 46204
Tel. (317) 633-2443

PARTICIPATION OFFERING
TO
U. S. STEEL CREDIT CORPORATION

BORROWER:

Justin Development Corporation (See Remark #4)

LOCATION:

North Side of Route 72 near Interstate 91
Cromwell, Hartford County, Connecticut

TYPE OF LOAN:

Construction (Rollover)

TYPE OF PROPERTY:

Construction of 150 condominium units in Phase I to be rolled over into additional phases containing a total of 450 units.

LOAN AMOUNT:
$3,290,000. - Rollover

APPRAISAL:

$5,058,750. (AFMC)

AMOUNT DISBURSED:
-0-

MATURITY:

Three (3) years from date of loan closing; individual unit construction loans not to exceed one (1) year.

PARTICIPATION OFFERED:

40%	($1,316,000.)	U. S. Steel Credit Corporation
50%	($1,645,000.)	American Fletcher Mortgage Investors
10%	($ 329,000.)	American Fletcher National Bank
	$3,290,000.	

ESTIMATED YIELD:

Four percent (4%) above AFNB base rate, adjusted as necessary.

REMARKS:

1. The security consists of approximately 40 acres located on the north side of Route 72 near Interstate 91 in Cromwell, Hartford County, Connecticut,

on which a total of 450 condominium units are to be built. The amount of this construction loan is to cover construction of Phase I consisting of 150 units and is to be rolled over into additional phases.

2. Average sale price of the units to be constructed will be $33,725. Repayment to the construction loan will be made through unit sales at a rate of 65% of the unit sale price.
3. Construction not to exceed 100 spec units at any one time. Additional starts will be allowed upon each individual sale on a one for one basis. The outstanding construction loan balance will not exceed $3,290,000. at any time.
4. The borrower is the Justin Development Corporation of White Plains, New York. On April 12, 1973, the Executive Committee of AFMI approved a 50% participation along with a 10% participation approval from AFNB on the construction loan. The principals of Justin Development Corporation are Mr. Michael S. Puntillo, with a net worth of $3,500,000.; Mr. Donald J. Colasono, net worth $941,400.; Mr. Gene L. Simms, net worth $1,105,000.; Mr. Robert A. Freeman, net worth $308,500.; Mr. Robert G. Schuermann, net worth $161,300. The total combined net worth is $6,016,000. Each of the above individuals will personally guarantee the entire amount of this loan.
5. Construction on the subject site will have the protection of performance and labor and material payment bonds.

PARTICIPATION AGREEMENT

THIS AGREEMENT, made and entered into this 31st day of December, 1973, by and between AMERICAN FLETCHER MORTGAGE COMPANY, a national association (hereinafter called "Company") and U. S. STEEL CREDIT CORPORATION, a Delaware corporation (hereinafter called "Corporation"),

WITNESSETH:

WHEREAS, Company is the holder of a certain loan obligation evidenced by a certain original Promissory Note dated ....., 1974, in the principal amount of Three Million Two Hundred Ninety Thousand and No/100 Dollars ($3,290,000.00), said Note being payable to Company or order and duly executed by Justin Development Corporation, photostat copy of said Promissory Note being attached hereto as Exhibit "A" (said Promissory Note being hereinafter called the "Note"); and

WHEREAS, Company is party to a certain Building Loan Agreement dated ....., 1974, by and between Company and the makers of the Note, governing the disbursement of proceeds and administration of the loan obligation evidenced by the Note, a photostat copy of said Building Loan Agreement being attached hereto as Exhibit "B";

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration, the parties hereto agree as follows:

1. a. Company hereby sells, transfers and conveys unto Corporation, without recourse, a ratable participating share of Forty Per Cent (40% or $1,316,000.00) in and to said Note, and all proceeds and avails of said Note and the security therefor, excepting fees collected by Company as compensation for the processing, closing and administration of the loan obligation (said participating share being hereinafter called the "Corporation Participation");

b. American Fletcher Mortgage Investors is to have a ratable participating share of Fifty Per Cent (50% or $1,645,000.00) and the American Fletcher National Bank and Trust Company is to have a ratable participating share of Ten Per Cent (10% or $329,000.00) in and to said Note, and all proceeds and avails of said Note and the security therefor;

2. Company shall hold the Note and all security therefor and all instruments and documents related to the loan obligation and all proceeds and avails thereof, in trust for the benefit of Corporation as its interests appear; and Company shall not modify nor consent to the modification of any terms of the loan obliagtion or release any of the security therefor without the written consent of Corporation, except in accordance with the terms of the Building Loan Agreement;
3. Company shall make disbursements of the proceeds of the Note in accordance with the terms of the Building Loan Agreement, and prior to the time of each such disbursement Corporation shall remit to Company upon forty-eight (48) hours notification an amount in cash equal to Forty Per Cent (40%) of the disbursement to be made; each such notification shall be deemed a representation by Company that, insofar as Company knows or is aware, no material breach of the Building Loan Agreement exists, and all terms of the Building Loan Agreement are in full force and effect;
4. Upon the making of each disbursement, Company shall advise Corporation, in writing, the amount of such disbursements, the cumulative amount of all disbursements made to date, the cumulative amount of all repayments of principal made to date, the outstanding interest and principal of the Note, the amount of the Corporation Participation, the amounts of all interest, principal, reimbursements of expense, or other proceeds and avails of the Note, which have been collected by Company and have not been distributed; and such other data and information as may be reasonably necessary to reflect the status of the loan obligation;
5. Company shall administer the loan obligation in accordance with the terms of the Building Loan Agreement, shall be responsible only for willful

misconduct, bad faith or gross negligence, and shall remit promptly to Corporation (a) all receipts of interest, principal, and other proceeds and avails of the Note and the security therefor to the extent of the Corporation Participation, and (b) all amounts received in reimbursements of costs and expenses to the extent that such costs and expenses have been paid by Company from funds provided by Corporation;

6. Company shall notify Corporation promptly of any material default in the terms of the loan obligation, or any other matter which, in Company's judgment, adversely affects the interest of Corporation, and in the event of any material default Company shall exercise all of its rights to enforce collection of the loan obligation either upon its own initiative or upon request by Corporation; and Corporation agrees to reimburse Company, upon demand, for all extraordinary out-of-pocket costs and expenses which may be incurred for the protection and preservation of security, for the minimizing of loss and for the enforcement of collection of the loan obligation by legal process or otherwise, including courts costs and reasonable attorney fees, to the extent of Forty Per Cent (40%) of such costs and expenses;
7. Company hereby warrants and represents that the aggregate amount of interest and other compensation in lieu of interest, if any, collected from or payable by the maker or guarantor of the Note does not and will not exceed the limitation, if any, upon the rate of compensation provided by applicable laws relating to usury, and hereby indemnifies Corporation against any and all loss or damage suffered on account of operation of any of such laws;
8. Neither Company nor Corporation shall sell except as set forth above or otherwise dispose of the Note or the Corporation Participation; pro-

vided, however, that upon request by Company, Corporation shall sell, transfer and convey unto Company the Corporation Participation for a cash price equal to (a) the unpaid interest and principal of the Note which at the time are represented by the Corporation Participation, and (b) all outstanding amounts of funds provided by Corporation to pay costs and expenses.

IN WITNESS WHEREOF, the parties hereto have caused this Participation Agreement to be executed in duplicate originals the day and year first above written.

Attest:

American Fletcher Mortgage Company

(Signatures Illegible)
Assistant Secretary

(Signatures Illegible)
Vice President

U. S. Steel Credit Corporation

(Signatures Illegible)
Assistant Secretary

(Signatures Illegible)
Vice President

EXHIBIT "C"

AMERICAN FLETCHER MORTGAGE COMPANY

An Affiliate Of The American Fletcher Corporation
AFMC
600 American Fletcher Building
Indianapolis, Indiana 46204
Tel. 317 633-2443

March 22, 1973

Justin Development Corporation
c/o Mr. Robert A. Freeman
Gaynor, Freeman, Glick and Pisani
271 North Avenue
New Rochelle, New York 10801

Re: Cromwell Village
Cromwell, Connecticut

Gentlemen:

We hereby commit to make a first mortgage land acquisition and development loan on the above referenced project under the following terms and conditions:

LOAN AMOUNT:

$2,530,000.

INTEREST RATE:

Five percent (5%) above the prime rate of the American Fletcher National Bank and Trust Company, per annum, from time to time in effect, payable monthly.

In addition, the borrower shall pay $25,000. (1%) on or prior to first disbursement. Additional amounts equal to 1% of the loan balance shall be payable at each loan closing anniversary date.

TERM:

Three (3) years from date of closing.

REPAYMENT:

Principal reduction to be made through unit sales at a rate of $7,000. per unit.

MORTGAGOR:

Justin Development Corporation

GUARANTOR:

Edward T. Edwards is to be liable for the entire amount of the land acquisition and development loan for the entire term of said loan.

SECURITY:

Approximately 40 acres located on the north side of Route 72 near Interstate 91 in Cromwell, Hartford County, Connecticut, to be developed for 450 condominium units.

DISBURSEMENTS:

$660,000. to be disbursed at loan closing for land acquisition; balance is to be disbursed as work is in place and supported by statements of certified costs as required by AFMC.

SPECIAL CONDITIONS:

1. All necessary and customary closing expenses are to be borne by you.
2. Documentation is to be satisfactory to us and our counsel.
3. Evidence of proper zoning, survey, utility availability, and title is to be submitted to us for our approval.
4. Detailed plans and specifications are to be submitted to us for our approval.
5. Construction must commence no later than sixty (60) days after loan closing.
6. The American Fletcher Mortgage Company is to have the exclusive right to arrange construction and permanent mortgage financing for the development of this property.

7. It is understood that we may offer this loan, or a portion thereof, to American Fletcher Mortgage Investors.
8. We are to be furnished with a satisfactory contract or contracts relative to the development of the property, together with performance and payment bonds satisfactory to us and our counsel.
9. We reserve the right to employ independent engineers, of our selection, at your expense, to certify costs and work in place as some proceeds.
10. Annual Audit Statements are to be provided to us at the close of each fiscal year.
11. You agree to comply with all governmental regulations, including, but not limited to applicable environmental statutes.
12. In the event that the borrower fails to take down this loan within sixty (60) days after acceptance of this commitment, liquidated damages will be due and payable to American Fletcher Mortgage Company of $25,300. (1%) to reimburse AFMC for expenses incurred herewith.

In order for this commitment to be valid and binding upon us, please acknowledge your understanding and acceptance of the terms and conditions contained herein by signing, dating, and returning to us the enclosed two carbon copies of this letter no later than April 5, 1973.

Very truly yours,

American Fletcher Mortgage Company

/s/ Herbert B. Feldmann
Herbert B. Feldman, President

/s/ John A. Nauert
John A. Nauert, Vice President

JPT/dsk

Approved and Accepted:
Justin Development Corporation

Edward T. Edwards

/s/ Robert A. Freeman
Secretary

Date: April 10, 1973

EXHIBIT "C"

AMERICAN FLETCHER MORTGAGE COMPANY

An Affiliate of the American Fletcher Corporation
600 American Fletcher Building
Indianapolis, Indiana 46204
Tel. (317) 633-2443

March 22, 1973

Justin Development Corporation
c/o Mr. Robert A. Freeman
Gaynor, Freeman, Glick and Pisani
271 North Avenue
New Rochelle, New York 10801

Re: Cromwell Village
Cromwell, Connecticut

Gentlemen:

We hereby commit to make a first mortgage construction loan on the above referenced project under the following terms and conditions:

LOAN AMOUNT:

$3,290,000. Rollover

INTEREST RATE:

Four percent (4%) above the prime rate of the American Fletcher National Bank and Trust Company, per annum, from time to time in effect, payable monthly.

In addition, the borrower shall pay 1% of the construction loan amount per unit at time of initial disbursement on each unit.

TERM:

Three years from date of closing; individual unit construction loans not to exceed one year.

REPAYMENT:

Principal reductions to be made through sales at a rate of 65% of unit sale price.

MORTGAGOR:

Justin Development Corporation

GUARANTOR:

Edward T. Edwards is to be liable for the entire amount of the construction loan for the entire term of said loan.

SECURITY:

150 condominium units in Phase I consisting of 15 one-bedroom units, 100 two-bedroom units, and 35 three-bedroom units.

DISBURSEMENTS:

Disbursements are to be made as work is in place and supported by statements of certified costs as required by AFMC.

SPECIAL CONDITIONS:

1. All necessary and customary closing expenses are to be borne by you.
2. Documentation is to be satisfactory to us and our counsel.
3. Evidence of proper zoning, survey, utility availability, and title is to be submitted to us for our approval.
4. Detailed plans and specifications are to be submitted to us for our approval.
5. Construction must commence no later than sixty (60) days after loan closing.
6. The American Fletcher Mortgage Company is to have the exclusive right to arrange permanent mortgage financing for the development of this property.

7. It is understood that we may offer this loan, or a portion thereof, to American Fletcher Mortgage Investors.
8. We are to be furnished with a satisfactory contract or contracts relative to the development of the property, together with performance and payment bonds satisfactory to us and our counsel.
9. We reserve the right to employ independent engineers, of our selection, at your expense, to certify costs and work in place as same proceeds.
10. Annual Audit Statements are to be provided to us at the close of each fiscal year.
11. You agree to comply with all governmental regulations, including, but not limited to, applicable environmental statutes.
12. Mortgagee to collect from the borrower $200.00 per unit at the time said unit is released by American Fletcher Mortgage Company.
13. In the event that the borrower fails to take down this loan within sixty (60) days after acceptance of this commitment, liquidated damages will be due and payable to American Fletcher Mortgage Company of $32,900. (1%) to reimbuse AFMC for expense incurred herewith.
14. Construction not to exceed 100 spec units at any one time. Additional starts will be allowed upon each individual sale on a one for one basis. The maximum exposure not to exceed $3,290,000. for any phase.

In order for this commitment to be valid and binding upon us, please acknowledge your understanding and acceptance of the terms and conditions contained herein by

signing, dating, and returning to us the enclosed two carbon copies of this letter no later than April 5, 1973.

Very truly yours,

American Fletcher Mortgage Company
/s/ Herbert B. Feldmann
Herbert B. Feldmann, President

/s/ John A. Nauert
John A. Nauert, Vice President

JPT/dsk

Approved and Accepted:

Justin Development Corporation
/s/ Edward T. Edwards
Edward T. Edwards

/s/ Robert A. Freeman
Secretary

Date April 11, 1973

BUILDING LOAN AGREEMENT

This instrument, executed in duplicate this 21 day of February, 1974, by and between JUSTIN DEVELOPMENT CORP., a New York Corporation, authorized to do business in the State of Connecticut, (hereinafter called the "Borrower"), and AMERICAN FLETCHER MORTGAGE COMPANY, INC., an Indiana corporation (hereinafter called the "Lender"),

WHEREAS, the Borrower as the owner in fee of or the owner of the leasehold estate in the lands hereinafter described in Exhibit "A" hereto attached and made a part hereof, has applied to the Lender for a mortgage loan to aid the Borrower in the construction of a certain condominium project (hereinafter called the "Project") in accordance with certain Drawings and Specifications hereinafter referred to.

NOW, THEREFORE, in consideration of the mutual promises hereinafter contained and of other valuable considerations, the parties hereto agree as follows:

1. The Borrower agrees to take and the Lender agrees to make (subject among other things, to this agreement) a loan in principal sum of $3,290,000.00, to be advanced as hereinafter provided, bearing interest from the date of each advance, said loan being evidence by certain collateral documents called the "Note" and the "Mortgage." (See Exhibit "D", a copy of said "Note", attached hereto and made a part of this instrument.)

2. The terms "Borrower" and "Lender" herein shall be construed to refer whenever applicable to "Owner" and "Mortgagee" respectively. Further, the term "Lender" herein shall be deemed to include any person to whom the Note and the Mortgage hereinbefore mentioned shall be assigned.

3. The Borrower agrees to erect the Project on the lands described in Exhibit "A" by July 1, 1977*** in accordance with Drawings and Specifications designated "Cromwell Condominiums" by Donald J. Colasono Associates, dated July 13, 1973, Job. No. 7305 no advance of funds shall be made by the Lender until complete and acceptable Drawings and Specifications, as determined by the Lender, are deposited with the Lender. Borrower authorizes Lender to disburse to Lender, the 1% construction loan fee, per unit, at time of initial disbursement of each unit. See Exhibit "C" for release fees per unit, to be collected by Lender, and for maximum number of units to be constructed at one time.

3. (a) At Lender's written request Borrow agrees to record required documents pursuant to the terms of Connecticut Statutes pertaining to condominiums and establishing individual, unit fee title structure. Lender agrees to execute a Consent to such documentation provided the documentation is in compliance with the aforementioned State law pertaining to condominiums and provided further that the lien of the Mortgage securing this loan as transferred to the unit fee estates created thereunder, is of equal dignity, priority and legal effect as said lien is on the date of execution, delivery and original recordation of said Mortgage.

(b) The Lender herein agrees, upon the request of the Borrower hereunder, to execute partial releases from the encumbrance of the Mortgage securing the indebtedness created herein under the conditions stated in this paragraph. The payment for such releases shall be that as provided for under the terms of the Exhibit "C" attached hereto and made a part of this Loan Agreement. Said partial releases will be issued upon the receipt of the required payments aforenoted and provided that the

*** subject to completion of each individual condominium unit, within one year from date of initial disbursement for that particular unit.

Lender, at Borrower's expense, receives an endorsement to Lender's Mortgagee Title Insurance Policy, insuring that said Title Insurance Policy is not adversely affected as to the coverage provided thereunder, by reason of the delivery and recordation of such partial release, and provided further that the note and mortgage securing this loan, and all other documents, are current, in full force and effect, and not in default.

(c) All of the terms of this Loan Agreement have been specifically incorporated by reference to the Mortgage securing the indebtedness created by this Agreement by specific language of incorporation contained in the Mortgage. It is hereby agreed and reaffirmed between Borrower and Lender that the provisions contained in this Loan Agreement are specifically incorporated by reference to and made a part of the Mortgage referred to herein, as if fully set forth in said Mortgage.

(d) Borrower agrees to retain majority control over any legal entity developed for the maintenance, supervision and administration of any common area and recreational facilities over, appurtenant to or for the benefit of the real estate securing this loan as described above. Said majority control will be maintained for so long as any portion of the loan balance referred to herein is outstanding.

4. The Borrower agrees that any and all requests for changes in said Drawings and Specifications must be in writing, signed by its authorized personnel and submitted to Lender for approval. No such changes shall be made without the consent of the Lender.

5. Applications for advances under this agreement are to be made by the Borrower to the Lender in a form and manner acceptable to the Lender. Said Applications shall be made once a month after the commencement of work hereunder, for work done during the preceding

month. Applications shall be filed with the Lender at least five days before the date upon which the advance is desired. Applications shall be in accordance with the Cost Breakdown initialed by the Borrower and attached hereto as Exhibit' 'B" and made a part hereof. The Borrower shall only be entitled to payment in an amount approved by the Lender with respect to each application.

The Borrower agrees as a condition precedent to the advance of any portion of the loan that the Lender may require the Borrower to furnish, among other things, at Lender's option:

a. A duly certified survey of recent date.

b. Satisfactory title evidence.

c. Acknowledgments of payment and release of liens from the general contractor, if any, and all subcontractors and materialmen dealing directly with the principal contractor, if any. The said acknowledgments and releases shall be in the form required by local lien laws and shall cover all work, labor and materials, including equipment and fixtures of all kinds done, performed, or furnished for the Project. The Lender may require the said acknowledgment and releases down to the date of the requested advance, and concurrently with the final payment for the entire Project.

d. Submission to the Lender and approval by Lender of the General Contract.

e. Submission to the Lender and approval by the Lender of a dual obligee Performance Bond with Labor and Material Payment Bond.

The Lender may at its option hold back from any advance an amount equal to 10% of the advance applied for, which amount shall be payable upon completion to the satisfaction of the Lender of the entire Project, including offsite utilities, if any, in accordance with afore-

said Drawings and Specifications. Final payment hereunder may be withheld until after the expiration of any period in which laborers, sub-contractors, or materialmen may have for filing Notices of Mechanics Liens.

Borrower agrees that Lender may at Lender's option require advances under this agreement be made through the facilities of a title company. Borrower further agrees to exercise any necessary document required by Lender or title company to perfect the disbursing arrangement.

If at any time, either prior to the commencement of construction or during the construction period, the projected cost of the improvements as estimated by the Lender, exceeds the amount of $3,290,000 for 150 units, the Lender may require the Borrower to deposit such excess with the Lender or the pertinent title company upon demand; such deposit is to be then utilized for construction costs before the Lender shall be required to make any further disbursements hereunder.

6. The Lender and its agents shall, at all times during construction, have the right of entry and free access to the Project and the right to inspect all work done, labor performed, and materials furnished in and about the Project and to inspect all books, sub-contracts and records of the Borrower.

For purposes of such inspections the Borrower shall notify Lender at the following stages of construction:

a. Caissons, footings, and reinforced concrete slabs immediately prior to placing concrete.
b. Roof and floor framing prior to sheathing.
c. Installation of mechanical piping before covering.
d. Rough-in of electrical in buildings before coving.
e. Rough-in of plumbing in buildings before covering.

f. On any request for funds if inventory of materials stored is to be included.

g. Final inspection of all phases of work.

Borrower and Lender agree that the purpose of Lender's inspections is to verify the progress of construction and in no manner can be taken to indicate or substantiate that work completed or being done is in accordance with the approved Drawings and Specifications.

7. The Borrower agrees that the Project shall be constructed entirely upon the premises mortgaged to the Lender by the Borrower and will not encroach upon or overhang any easement or right-of-way nor upon the land of others. The Project will be constructed strictly in accordance with all applicable building, zoning, deed and plat restrictions, statutes, ordinances, regulations and administrative orders, and in conformity with the requirements of the Board of Fire Underwriters or similar body. The Borrower will from time to time furnish satisfactory evidence of compliance with respect to the foregoing if required by the Lender. Borrower agrees to maintain insurance as provided in the mortgage and as required by the Lender and Local and State Laws.

8. The Borrower agrees that the Lender shall have a security interest in all building materials and all other personal property, including but not limited to carpeting, appliances and equipment placed upon the lands described in Exhibit "A" prior and subsequent to their incorporation into the improvements to be constructed, and that all of such building materials shall be free and clear of any lien or security interest of any other party when delivered to said lands. Borrower further agrees that the Lender may file any financing statements necessary to perfect its security interest in said personal property signed by the Lender alone. Borrower further agrees that should the Lender enter upon the premises to complete the Project as the Lender is empowered to do upon default of the Borrower under the provisions of Article

9 the Lender may use any of such materials in the completion of the Project.

9. If the Borrower at any time prior to the completion of the Project abandons the same or ceases work thereon for a period of more than twenty (20) days or fails to complete the erection of the Project strictly in accordance with the Drawings and Specifications, except as to changes approved as herein provided by the Lender, or makes changes in the Drawings and Specifications, without first securing written approval of the Lender, or otherwise fails to comply with the terms hereof. then such failure shall be deemed a default hereunder at the option of the Lender and the Lender at its option, may terminate this agreement or at any time thereafter may enter into possession of the premises and perform any and all work and labor necessary to complete improvements substantially according to Drawings and Specifications and may employ watchmen to protect the premises from injury; all sums so expended by Lender to be deemed paid to Borrower and secured by said Mortgage. For this purpose, the Borrower hereby constitutes and appoints the Lender its true and lawful attorney-in-fact with full power of substitution in the premises, to complete the Project in the name of the Borrower, and hereby empowers said attorney or attorneys as follows: To use any funds of the Borrower, including any balance which may be held in escrow and any funds which may remain unadvanced under the Mortgage for the purpose of completing the Project in the manner called for by the Drawings and Specifications hereinbefore mentioned; to make such additions and changes and corrections in the Drawings and Specifications which shall be necessary or desirable to complete the Project in substantially the manner contemplated by the Drawings and Specifications; to employ such contractors, sub-contractors and agents, architects and inspectors as shall be required for said purposes; to pay, settle or compromise all existing bills and claims which may be liens against the said Project, or as may be neces-

sary or desirable for the completion of the job, or the clearance of title; to execute all applications and certificates in the name of the Borrower which may be required by any of the contract documents and to do any and every act which the Borrower might do in its own behalf, including but not limited to the execution of all permanent loan documents.

It is further understood and agreed that this power of attorney shall be deemed to be a power coupled with an interest and cannot be revoked. The above mentioned attorney shall also have power to prosecute and defend all actions or proceedings in connection with the construction of the Project or mortgaged premises and to take such action and require such performance as he deems necessary. The Borrower hereby assigns and quit claims to the Lender all sums unadvanced under said Mortgage and all sums due in escrow conditioned upon the use of said sums in trust for the completion of the Project, such assignment to become effective only in case of the Borrower's default.

10. The Borrower agrees to comply with all the terms and conditions of certain commitment letters described, in brief, as follows: *Letter from Lender to Borrower dated March 22, 1973; and Letter from Lender to Borrower dated May 21, 1973, and Letter from Lender to Borrower dated November 21, 1973.* Said letters have been accepted by Borrower and are attached hereto as Exhibit "C" and made a part hereof.

11. The Borrower further agrees that the Lender may, at its option, waive any of its rights under any one or more of the provisions of this agreement, but that such waiver shall not constitute waiver of any other or all provisions not specifically waived, nor shall it give rise to a duty on the part of the Lender in the future to continue to waive any of its rights.

12. This instrument shall be binding upon the parties hereto and their respective successors and assigns.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be executed this 21 day of February, 1974.

Signed, Sealed and Delivered in the presence of:
Francis X Cavanaugh
Sandra C. Teichert

Justin Development Corp.
A Corporation
By: Robert Schuermann,
Its President
By: Robert A. Freeman
Its Secretary

American Fletcher Mortgage Company, Inc.
By: Milton Learner

Attest:

STATE OF CONNECTICUT)
) SS: GREENWICH
COUNTY OF FAIRFIELD)

Before me, the undersigned, a Notary Public in and for said County and State, this 21 day of February, 1974, personally appeared JUSTIN DEVELOPMENT CORP., a New York Corporation authorized to do business in the State of Connecticut, by Robert Schuermann and Robert A. Freeman, its President and Secretary respectively, signers and sealers of the foregoing instrument and acknowledged the execution of the foregoing instrument as their free act and deed and the free act and deed of said corporation, for the purposes and uses stated therein.

WITNESS my hand and Notarial Seal.

/s/ Sandra C. Teichert
Notary Public

My Commission Expires:
March 31, 1974

COUNTY OF MARION)
) SS:
STATE OF INDIANA)

Before me, the undersigned, a Notary Public in and for said County and State, this .... day of ....., 1974, personally appeared ..... respectively, of American Fletcher Mortgage Company, Inc., who as such officers, for and on its behalf, acknowledged the execution of the foregoing instrument.

WITNESS my hand and Notarial Seal.

.....
Notary Public

My Commission Expires:
.....

This instrument prepared by:
Milton Learner
600 American Fletcher Building
Indianapolis, Indiana 46204

EXHIBIT "A"

A certain piece or parcel of land situated on the westerly side of Willowbrook Road, in the Town of Cromwell, County of Middlesex and State of Connecticut, more particularly described on map entitled "Survey Map Property of Justin Development Corp., Cromwell, Conn., Igor Vechesloff Professional Engineer & Land Surveyor, 51 Lorraine Street, Hartford 5, Connecticut, Scale 1" — 100', Date 3/5/69, Revised 10/20/72 and Revised 5/11/73, Drawing No. 1107," and bounded and described as follows:

Commencing at a point in the westerly line of Willowbrook Road at the intersection of the northeasterly corner of property now or formerly of H. & S. Tool Co., and the southeasterly corner of the premises herein described; thence running along the northerly boundary line of property now or formerly of H. & S. Tool Co., South 77°54'35" West 889.06 feet to a point in the northerly boundary line of Nike Road; thence running along the northerly boundary line of said Nike Road North 80°13' 25" West 172.48 feet to a point at the intersection of property now or formerly of Arthur H. Alden III and Joseph G. Perotti; thence running along the easterly line of property of Alden and Perotti, North 12°25'17" West 607.94 feet to a point; thence running North 64°31'01" West 200.00 feet to a point; thence running North 15°00' 00" East 739.25 feet to a point; thence North 75°00'00" West 191.98 feet to a point in the easterly boundary line of property now or formerly of William F. Harrington, et al; thence along the easterly boundary line of land of said Harrington, et al and land of James M. Davidson North 1°30'00" East 405.60 feet to a point at the intersection of land now or formerly of Thomas Kelly; thence running along the southerly boundary line of land of said Kelly, South 84°05'00" East 217.35 feet to a point; thence continuing along the southerly line of land of said Kelly, South 70°15'32" East 61.19 feet to an iron pin; thence continuing along the southerly boundary line of said Kelly,

South 80°20′50″ East 853.54 feet to a point, 3.56 feet west of an iron pin, said point being located in the westerly boundary line of Willowbrook Road; thence running along the westerly line of said Willowbrook Road, South 8°57′ 01″ West 93.125 feet to a point; thence continuing along the westerly boundary line of said Willowbrook Road South 0°18′00″ East 547.07 feet to a point; thence continuing along the arc of a curve on the westerly boundary line of said Willowbrook Road, said curve having a central angle of 11°03′15″ and a radius of 300.00 feet, 154.345 feet to a point; thence continuing along the westerly line of said Willowbrook Road South 11°21′15″ East 347.83 feet to a point; thence continuing along the westerly line of said Willowbrook Road, South 19°18′02″ East 180.99 feet to a point; thence continuing along the said westerly line of Willowbrook Road, South 21°28′25″ East 132.89 feet to a point; thence continuing along the westerly line of said Willowbrook Road South 25°55′25″ East 86.70 feet to the point of beginning.

Containing 41.285 acres.

Payment No. 1

r the period: August 20, 1973 to February 4, 1974 ,inclusiv

me of Job Willowbrook Commons — Our Job No.

Cromwell, Connecticut — Your Job No.

P. O. No.

Route 72 at Country Squire Road
cation of Work — Sheet No.

ntractor's Name Jobco, Inc. — Contract Price $3,290,000 (Lump Sum)

ntractor's Address Great Neck, New York — Estimated Price $ (Unit Sum)

tem mber	Subcontractor/Material Dealer	Total Contract	Earned to Date	Retainage	Amounts Previously Paid	Amounts to be Paid
	Dwelling Units:					
1	General Conditions	130,130	55,409			55,409
2	Building Excavation	113,725	42,383			42,383
3	Concrete Work	286,489	33,626			33,626
4	Structural Steel	31,209	22,073			22,07:
5	Carpentry	1,262,962	35,250			35,25(
6	Roofing & Sheet Metal	30,026	1,000			1,00(
7	Dampproofing & Caulking	16,196	-0-			-0-
8	Kitchen & Lav. Cab.	105,090	-0-			-0-
9	Drywall	322,515	-0-			-0-
10	Painting	78,610	-0-			-0-
11	Flooring	109,640	-0-			-0-
12	Hardware & Toilet Acces.	21,928	-0-			-0-
13	Windows & Sl. Doors	60,235	-0-			-0-
14	Fireplaces	17,379	-0-			-0-
15	Refrig.,Range,Dish., Disp.	114,372	-0-			-0-
16	Electrical	158,947	-0-			-0-
17	Plumbing	192,535	4,400			4,40(
18	HVAC	210,012	-0-			-0-
19	Bond Premium	23,000	22,638			22,63.
	TOTAL	3,290,000	216,779			216,77:

I hereby certify that the aforementioned total contract price of $3,290,000.00 represents the total costs to construct 150 units, as per breakdown on attached sheet.

JUSTIN DEVELOPMENT CORP.

By: Robert Schuermann, President

B 1

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IT & BUILDING DESIGNATION	TOTAL CONSTRUCTION COSTS ALLOCATED PER UNIT	FIRST DRAW, LESS RETAINAGE	SECOND DRAW, LESS RETAINAGE	THIRD DRAW, LESS RETAINAGE	FOURTH DRAW, LESS RETAINAGE	FIFTH DRAW, LESS RETAINAGE	TOTAL DISBURSEMENTS TO DATE, PER UNIT
Unit A	15 x 17,250 = 258,750						
Unit B	60 x 21,700 = 1,302,000						
Unit B^1	40 x 22,450 = 898,000						
Unit C	35 x 23,750 = 831,250						
	150 3,290,000						

EXHIBIT "D"

NOTE

$2,530,000 DUE: June 1, 1976

Cromwell, Connecticut, ..., 1973

On or before June 1, 1976, for value received, the undersigned, jointly and severally, promise to pay to the order of

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,

At its main office in the City of Indianapolis, Indiana the principal sum of Two Million Five Hundred Thirty Thousand and no/100 ($2,530,000.00) Dollars or so much thereof as is from time to time advanced hereunder, with interest on the balance of principal remaining unpaid from time to time at the rate of five per cent (5%) per annum above the daily "Base Rate" in effect at American Fletcher National Bank and Trust Company of Indianapolis. Indiana until maturity or so long as there is no uncured default in the payment of any installment of principal or interest hereunder, and with interest at the rate of fourteen per cent (14%) per annum, after maturity and while there exists any uncured default hereunder, until paid, said principal and interest being payable as follows:

> Interest only at stated rate is due and payable on June 1, 1973 and on first day of each month thereafter including the first day of June, 1976, the entire balance of principal together with any unpaid interest shall be due and payable on June 1, 1976;

all without relief from valuation or appraisement laws and with attorney's fees and costs of collection, authorized under applicable law.

This Note is secured by a Real Estate Mortgage of even date herewith executed, acknowledged and delivered by the Makers hereof to the Payee and secured by Real

Estate located in Middlesex County, Connecticut. Upon failure to pay the principal or interest, or any installment of principal or interest of this Note when due, or upon failure to comply with any of the terms, provisions and conditions of the Mortgage securing the payment hereof, all of the indebtedness then unpaid shall, at the option of the holder hereof, become immediately due and collectible without notice.

The Makers and endorsers severally waive presentment for payment, protest, notice of protest and notice of non-payment of this Note.

The Makers shall have the privilege of prepaying the indebtedness evidenced hereby only with the written consent of the holder. Delay in exercising any of the holder's rights or options hereunder shall not constitute a waiver thereof, and waiver of any right or option shall not constitute a waiver of the right to exercise the same in the event of any subsequent default. Makers and endorsers hereof hereby jointly and severally consent to the extension of time for the payment of this Note or any installment hereof, any modification hereof, release from liability of any maker, endorser, guarantor, or any other person or entity at any time liable for the payment hereof, and the modification or release of any collateral at any time held as security of this Note, without notice and without affecting the liability of any maker or endorser.

Time is of the essence of this Note. This is an acquisition/development loan for a business purpose; multiple advances will be made hereunder, interest shall accrue from the date of each such advance.

JUSTIN DEVELOPMENT CORP.,
A Corporation
By .....
Its President
By .....
Its Secretary/Treasurer

EXHIBIT "D"

NOTE

$3,290,000.00 DUE:....., 1977

Cromwell, Connecticut,....., 19....

On or before ....., 1977, for value received, the undersigned, jointly and severally, promise to pay to the order of

AMERICAN FLETCHER MORTGAGE COMPANY., INC.,

at its main office in the City of Indianapolis, Indiana, the principal sum of Three Million Two Hundred Ninety Thousand and no/100 Dollars ($3,290,000.00) or so much thereof as is from time to time advanced hereunder, with interest on the balance of principal remaining unpaid from time to time at the rate of four per cent (4%) per annum above the daily "Base Rate" in effect at American Fletcher National Bank and Trust Company of Indianapolis, Indiana until maturity or so long as there is no uncured default in the payment of any installment of principal or interest hereunder, and with interest at the rate of fifteen per cent (15%) per annum, after maturity and while there exists any uncured default hereunder, until paid, said principal and interest being payable as follows:

> Interest only at stated rate is due and payable on ....., 1974, and on the first day of each month thereafter, including the first day of .... 1977, the entire balance of principal together with any unpaid interest shall be due and payable on ....., 1977;

all without relief from valuation or appraisement laws and with attorney's fees and costs of collection, authorized under applicable law.

This Note is secured by a Real Estate Mortgage of even date herewith, executed, acknowledged and delivered

by the Makers hereof to the Payee and secured by Real Estate located in Middlesex County, Connecticut. Upon failure to pay the principal or interest, or any installment of principal or interest of this Note when due, or upon failure to comply with any of the terms, provisions and conditions of the Mortgage securing the payment hereof, all of the indebtedness then unpaid shall, at the option of the holder hereof, become immediately due and collectible without notice.

The Makers and endorsers severally waive presentment, protest, notice of protest and notice of non-payment of this Note.

The Makers shall have the privilege of prepaying the indebtedness evidenced hereby only with the written consent of the holder. Delay in exercising any of the holder's rights or opinions hereunder shall not constitute a waiver thereof, and waiver of any right or option shall not constitute a waiver of the right to exercise the same in the event of any subsequent default. Makers and endorsers hereof hereby jointly and severally consent to the extension of time for the payment of this Note or any installment hereof, any modification hereof, release from liability of any maker, endorser, guarantor, or any other person or entity at any time liable for the payment hereof, and the modification or release of any collateral at any time held as security of this Note, without notice and without affecting the liability of any maker or endorser.

Time is of the essence of this Note. This is a construction loan for a business purpose; multiple advances will be made hereunder, interest shall accrue from the date of each such advance.

JUSTIN DEVELOPMENT CORP.

By .....
Its President

By .....
Its Secretary

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
AND AMERICAN FLETCHER CORPORATION,
Counterdefendants.

Cause No. IP 76-276-C

MOTION TO DISMISS OR FOR JUDGMENT ON THE PLEADINGS AS TO SECURITIES LAWS CLAIMS

Counterdefendants American Fletcher Mortgage Company, Inc., American Fletcher National Bank And Trust Company and American Fletcher Corporation hereby move the Court for judgment on the pleadings dismissing Counts [illegible], V, VI, VII and VIII of "U.S. Steel Credit Corporation's Amended Counterclaim And Amended Claim Against Counter-Defendant," filed January 8, 1979, and Counts IX, X and XI of the "Second Amendment To Amended Counterclaim And Amended Claim Of U.S. Steel Credit Corporation" submitted February 9, 1979, with leave to file granted Steel on April 10, 1979. Each such count purports to assert violations by the counterdefendants of the federal (Counts I and V through VIII) or state (Counts IX through XI) securities laws.

The reason for the motion is that as a matter of law, the participation by U.S. Steel Credit Corporation

("Steel") in loans to Justin Development Corporation did not constitute the purchase or sale of a "security" within the meaning of the federal or state securities laws. Because no "security" is involved, Steel's securities claims must be dismissed.

The insufficiency of Steel's securities law claims is clear from the face of Steel's pleadings, including the exhibits thereto. To the extent the Court may rely upon matters outside the pleadings, counterdefendants request that this motion be treated as a motion for summary judgment pursuant to Rules 12(b) and (c) and Rule 56 of the Federal Rules of Civil Procedure.

A brief in support of this motion is submitted herewith.

Respectfully submitted,

/s/ Theodore R. Boehm
/s/ James H. Ham, III
Attorneys for the plaintiffs and counterdefendants American Fletcher Mortgage Company, Inc., American Fletcher National Bank And Trust Company and American Fletcher Corporation

THEODORE R. BOEHM
JAMES H. HAM, III
BAKER & DANIELS
810 Fletcher Trust Building
Indianapolis, Indiana 46204
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EXHIBIT "C"

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

vs.

U. S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
AND AMERICAN FLETCHER CORPORATION,
Counterdefendants.

Cause No. IP 76-276-C

U. S. STEEL CREDIT CORPORATION'S CROSS-MOTION FOR SUMMARY JUDGMENT THAT ITS PATICIPATIONS WERE "SECURITIES" UNDER FEDERAL AND STATE SECURITIES ACT

U. S. Steel Credit Corporation ("USSC"), by counsel, pursuant to Rule 56 of the Federal Rules of Civil Procedure, hereby moves the Court for Summary Judgment, declaring that its "participations", acquired from American Fletcher Mortgage Company ("AFMC") in connection with the Cromwell, Connecticut, condominium loans were "securities" within the meaning of the Federal and State of Indiana Securities Acts.

The grounds of this Motion are that there is no genuine issue of material fact in respect of the status of such participations as "securities" and that USSC is entitled to summary judgment on this issue, raised in its counterclaim herein, as a matter of law.

In support of this Motion, USSC files herewith a Brief, setting forth the applicable Counts of its Counterclaim, as amended, in which such "securities" issues are raised against the Counter-Defendants, as well as the applicable principles of law and ruling authorities.

In further support of this Motion, USSC files herewith the Affidavit of Nicholas C. Nizamoff, one of USSC's counsel, verifying the citations of deposition testimony referred to in the accompanying Brief.

/s/ William A. Wick
Attorney for U. S. Steel Credit Corporation

Of Counsel for U. S. Steel Credit Corporation:
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11 South Meridian Street
Indianapolis, IN 46204
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Motion was this 22nd day of February, 1980, served upon Theodore R. Boehm, Esq. and James H. Ham, III, Baker & Daniels, 810 Fletcher Trust Building, Indianapolis, Indiana 46204, by depositing a copy of same in the United States mail, postage prepaid.

/s/ William A. Wick

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

AMERICAN FLETCHER MORTGAGE COMPANY, INC., and
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
Plaintiffs,

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U. S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

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AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,
AND AMERICAN FLETCHER CORPORATION,
Counterdefendants.

Cause No. IP 76-276-C

AFFIDAVIT OF NICHOLAS C. NIZAMOFF

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

Before me, a Notary Public in and for the aforesaid county and state, personally appeared Nicholas C. Nizamoff, who being first duly sworn upon his oath, deposes and says:

1. Affiant is one of the counsel for U. S. Steel Credit Corporation, Defendant and Counterclaimant in the above-entitled action.

2. As such counsel, affiant personally participated in the taking of the depositions, referred to below, and can verify that the deposition testimony, referred to in U. S. Steel Credit Corporation's accompanying Brief faithfully reports the deposition testimony set forth in affiant's copy of the transcript of such testimony.

3. The deposition of Stanley John Mack was initially taken on behalf of American Fletcher Mortgage Company on the 7th, 8th and 9th days of March, 1978, in Indianapolis.

4. Mr. Mack testified that he had been employed by U. S. Steel Credit Corporation since January, 1970, with the title of Assistant Treasurer and Assistant Secretary (Mack dep. p. 9).

5. After testifying that 90 to 95% of the Credit Corporation's financing involved real estate construction loans (Mack dep. p. 22) and being asked if transactions involving millions of dollars were at stake, Mr. Mack answered as follows:

> "Yes. I wonder if I could clarify. When we talked of real estate loans, the Credit Corporation does not as a practice lead a loan. We are a participating lender. We buy participations from other lead lenders."

6. Asked at a later point what types of loans were involved, Mr. Mack testified (p. 25):

> "But there is no set percentage of a type of loan that we're seeking to participate in.
>
> We're currently involved in hotel financing, shopping centers, condominiums, small industrial warehouses. I guess that is pretty much it."

7. Asked if the Credit Corporation had any written "guidelines for suitable investments," Mr. Mack answered "No", but he said that the Credit Corporation did have rules of thumb, as follows:

> "We stay in short term investments, interim-type loans. Generally loans that are restricted to the construction." (Mack dep. p. 87)

8. He then added (p. 87):

> "We do not want to be, as I indicated, a lead lender. We do want to have the lead retain a substantial part of the loan."

9. Asked whether USSC raised money for its investments with a line of credit, Mr. Mack responded (p. 11):

> "Usually we raise our money through commercial paper. We do have a line of credit, but commercial paper normally has been our source for funds."

10. Affiant also participated in the deposition of William H. Lang, taken on behalf of the Plaintiff in Tampa, Florida, on January 8, 1980.

11. Mr. Lang testified that in 1973 he was either President or Chairman of U. S. Steel Credit Corporation (Lang dep. p. 5) and that he is presently retired (Lang dep. pp. 5-6).

12. At a later point in his deposition, in response to a question as to the reason for the Credit Corporation's interest in having the lead bank retain a share of the loan, Mr. Lang responded:

> "A lead lender's responsibility is a principal reliance upon which an investor, such as a credit corporation, would be basing its decision."

13. Affiant also participated in the deposition of W. Bruce Thomas, taken in Pittsburgh on January 17, 1980.

14. Mr. Thomas testified that in 1973 he was President of U. S. Steel Credit Corporation and remained in that position until mid-1975 (Thomas dep. p. 3). He also held and still holds positions with U.S. Steel Credit Corporation's parent, United States Steel Corporation.

15. On the subject of U. S. Steel Credit Corporation's reliance upon the lead bank, Mr. Thomas testified:

> "No. Our method always was to rely on the local bank for the administration. They were in the community, they knew the people. It was customers of theirs. They were on site. They had an organization designed to do that. We never staffed this organization [USSC] to do the sort of thing you were talking

about. We relied on the lender, originator of the loan, to do that work."

16. Asked what the lead lender was expected to do if it identified a problem in connection with the loan, Mr. Thomas testified:

"Well, I think we felt they had an obligation to advise us at the earliest opportunity that there were problems in the loan." (Thomas dep. p. 25)

17. Thereafter the questions and answers of Mr. Thomas continued as follows:

"Q. And having done that, what then are you or they supposed to do?
A. They would continue to handle the administration of it. We would, even at that point, have no role in it except to start worrying I guess, about our loan.
Q. Did you feel that it was up to them to attempt to make some sort of a recommendation to you, and if there were other participants, them as well, as to what to do about the situation?
A. Yeah. Well, they would in the normal course have to develop a recommendation. We typically were a minor investor in the total loan, so they had a bigger stake or they or other investors together had a bigger stake than we did. And it was the bank's responsibility to develop a recommendation and make it to us.
Q. It is fair to say that part of your basic approach to these participations was to take essentially a minority position and rely in significant part on the fact that the leading bank had its own money in the project and, therefore, would presumably do what it thought was best?
A. Well, it had its own money, it had its reputation, it had a group that were in the business of administering these types of loans. And we did, you know, we had these investments all over the country." (Thomas dep. pp. 25-26).

18. On the subject of reliance upon the lead bank, Mr. Mack gave the following testimony:

"Q. Now generally, what do you consider in reviewing the proposal and determining whether to recommend it?

A. I guess the first thing is who is offering it to us. And what we might know about them, the bank or the mortgage company or mortgage banker.

Q. Generally whether the—

A. Are they competent so far as we know at the time.

Q. What do you do to form a judgment as to whether they are or not competent?

A. The vast majority have a relationship with U.S. Steel. A commercial relationship with U.S. Steel.

And this is the biggest source of proposals to us, these banks. And these banks have mortgage companies or mortgage departments. And in one way or another, they become aware of the services of the credit corporation.

And we then become acquainted with that particular department, mortgage department or mortgage subsidiary, as the case may be. The credit corporation, see.

We would be reluctant to do business with just some strange bank that we had no knowledge about.

So as I indicated, the first is with whom are we doing business? Where is the proposal coming from?" (Mack dep. pp. 43-44).

19. Further testifying on USSC's reliance on the lead bank, Mr. Mack gave the following answers to the following questions:

"Q. You just assume that the architect is competent?

A. Well, we do more than that. We assume that the lead lender has made an analysis of it.

Q. You assume that the lead lender has done things like look at it from a structural point of view?

A. Has had his cost people and his engineering people review those plans and specs, yes.
Q. You think that lead lenders review them from an engineering point of view?
A. Yes. I know they do in some cases, depending on the type of structure." (Mack dep. p. 48)

20. Further on the role of a leader, Mr. Mack gave the following testimony in response to the following questions:

"Q. What do you understand the role of the lead lender to be in that kind of arrangement in general?
A. The role of the lead lender would be to originate the loan.

And usually this is one of his customers, people that he has done or developers that he has done business with and knows.

He would obtain the information necessary for him to make a determination whether or not he wanted to make the loan. He would negotiate the terms and conditions and the rate. He would develop the information about the borrower, about the project. Do the analysis. Go through the necessary steps in review of legal documents. Make sure that the project had the necessary approvals, zoning and environmental. He would review the cost.

And if the project was substantially enough, he would have his analysis review the builder's estimated cost. He would have his people review the budget. He might have his engineers review the drawings and specifications.

And then once he had developed all this information and was seeking a participant, he would discuss generally the outline of what he proposed to do.

And once the participant agreed to participate with them and executed the agreement and the project got underway, he would administer that project. He would send his people out to inspect the progress. He would send his people out to inspect the progress.

He would require, again depending on the size of the project, certification from the inspecting architect or inspecting engineer.

The proper certification from the general contractor, from the developer. He would monitor the dispersements [sic]. He should inspect the project again, depending on its size how frequently, and determine if the moneys were going into what they were supposed to go into. That the dollars and materials were going into place.

And determine as he went along through his engineering people or cost analysts that there were sufficient funds left in the loan to complete.

And if there were not, if any problems arose, he would get in touch with the participants and indicate what they were. And attempt to resolve those problems, whatever they might be. And carry the project through to conclusion.

If the project got into trouble, he would handle the necessary negotiations in attempting to solve that with the borrower or other parties that might be involved, guarantors or whatever, with the concurrence of the participants, checking with them, getting their input.

If a foreclosure became, or however you attain title of a property, to take it over, complete it or do whatever is necessary to liquidate that asset and pay off everybody that was involved in it." (Mack dep. pp. 79-81)

21. In connection with the building loan agreement, Mack also testified that USSC relied upon AFMC to see that it was properly closed and executed (Mack dep. p. 279):

"But I was also relying on American Fletcher to execute the document properly. And I had a fairly decent idea as to what would be in that building loan agreement from the previous building loan agreements."

22. Mr. Mack further testified to his reliance upon advice of Mr. Trepinski of AFMC, concerning the personnel of Justin Development Company, the developer-borrower (Mack dep. p. 304):

> "But I seem to remember a conversation concerning the principals. And they appeared to have the mix of backgrounds that looked good.
>
> They had a knowledgeable, experienced developer. They had an experienced mortgage man who handled their financing of permanent mortgage. Then they had an experienced architect and a reliable, reputable general contractor.
>
> So the various requirements or expertise seemed to be present among that group."

23. The deposition of James T. Trepinski was taken in Cleveland, Ohio on behalf of U.S. Steel Credit Corporation on July 20, 1977.

24. Mr. Trepinski testified that he had been a vice president of Toledo Home Mortgage Company, which was acquired by AFMC in August, 1969 (Trepinski dep. p. 32). He then became vice-president in charge of loan production for the Ohio division of AFMC (p. 33). He was then promoted to senior vice-president of AFMC and moved to Indianapolis (p. 34).

25. Questioned as to the procedures followed by AFMC in originating, processing and servicing a construction loan, Mr. Trepinski testified (Trepinski dep. pp. 50-51):

> "The Loan Originating Department would entertain the construction loan request from a client, would consider that request, review it, underwrite it, recommend it to AFMC's loan committee; upon approval would turn the situation over to the Legal Department for an orderly closing.
>
> The Legal Department would manage that closing and would supervise that construction loan through its completion and also supervise, if appropriate, the delivery of that loan to a permanent investor."

26. As to the origination of loans by AFMC, Mr. Trepinski testified to the following information, which AFMC would seek from the prospective borrower as a basis for evaluating the loan (Trepinski p. 52):

> "That information would include everything involved with the project itself. By that I'm talking about such things as appraisals, contracts, surveys, architectural works, drawings, contractor bonding capability, market study reports, demographic material and all of the types of information concerning the borrowing in entity, whatever it might be."

27. As to evaluation of the information supplied to AFMC by the prospective borrower, Mr. Trepinski testified that "the preliminary evaluation would be made by that loan officer" (p. 53). The loan officer, he said, did the "preliminary screening and underwriting of the proposed deal" (p. 54), then prepared a "summary analysis" (p. 55). Mr. Trepinski went on to testify that he would examine the summary analysis and decide whether to take the next step of submitting it to the Loan Committee (p. 55).

28. As to the information which AFMC would expect to have in hand before submission of the prospective loan to its Loan Committee, Mr. Trepinski testified that it would include the following (pp. 57-58):

> "Included with that, but not necessarily only these items, a full appraisal, full and complete analysis of the market in the event of being an income type property, an analysis of leases, survey information, complete construction costs, proposal data on proposed contractors, data on the borrowing entity and its worth, time frame schedules for construction; if appropriate, information on sales capability or leasing capability, to name some of the major items."

29. Trepinski also testified concerning plans and specifications (dep. p. 62):

"Plans and specifications would be required to be reviewed by the loan officer, compared to the general proposal, delieverd to the Legal Department also for for review."

30. Trepinski also testified that AFMC would require the borrower to submit a breakdown of his estimated construction costs, the purpose being (dep. 71):

"to evaluate the overall cost of the project and loan amount, resultant loan amount to determine whether or not such request was reasonable."

31. In the case of new borrowers, with whom AFMC had had no prior experience, Trepinski testified that (dep. p. 76):

"AFMC would require not only the financial information submitted by the proposed borrower, but would also undertake to conduct his own investigation of that proposed borrower's financial condition."

32. Mr. Trepinski went on to testify that after approval by the Loan Committee of the prospective loan, the Loan Origination Department would prepare a participating offering (Trepinski dep. p. 171). At a later point in his deposition, Mr. Trepinski identified the particular participation offerings, which were submitted to U.S. Steel Credit Corporation in connection with the Cromwell loan, copies of which, designated as deposition exhibits 73 and 74, are attached to this Affidavit. (dep. p. 280, 281).

33. Tr. Trepinski also testified to other information, which customarily would have been submitted to a proposed participant, as follows (dep. pp. .....):

"Q. What other material would have been supplied to the participating lender?
A. The type of material that we discussed yesterday.
Q. The surveys and plats and appraisals and . . .
A. Yes. That's right.

Q. Would cost breakdowns have been supplied?
A. Normally, yes.
Q. Would feasibility studies have been supplied?
A. It could well be, yes.
Q. Would financial statements of the principals involved be supplied?
A. Yes; yes."

34. As to the particular documentation, which was supplied to USSC, AFMC Requests for Admissions and USSC's Responses thereto, as filed in this action, show the receipt by USSC in 1973 of such documents as the following: an Appraisal (Ex. 1001), a Marketing and Feasibility Report (Ex. 1002) and LA&D Loan Cost Breakdown (Ex. 1003), Puntillo (contractor's president) financial data (Exs. 1011, 1012), financial data on principal officers of the Developer Justin Development Corporation (Exs. 1013-1031), financial statements of Developer and Contractor (Exs. 1032, 1033, 1034).

35. And further affiant saith nought.

/s/ Nicholas C. Nizamoff
Nicholas C. Nizamoff

Subscribed and sworn to before me, a Notary Public in and for the above said County and State, this 22 day of February, 1980.

/s/ Brenda L. Jackson
Notary Public
/s/ Brenda L. Jackson
(Printed)

My commission expires:
8-13-82

County of residence:
Marion

UNITED STATES DISTRICT COURT
Southern District of Indiana
Indianapolis Division

AMERICAN FLETCHER MORTGAGE COMPANY, INC, and
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY,

Plaintiffs,

vs.

U.S. STEEL CREDIT CORPORATION,
Defendant and Counterclaimant,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY, and
AMERICAN FLETCHER CORPORATION,
Counter-Defendants.

Cause No. IP 76-276-C

SUPPLEMENTAL AFFIDAVIT OF STANLEY J. MACK

State of Florida)
) SS:
County of Dade)

Stanley J. Mack, being first duly sworn upon his oath, deposes and says:

1. Affiant is and has been since 1973, as well as prior thereto, Assistant Treasurer and Assistant Secretary of U. S. Steel Credit Corporation ("USSC"). Affiant was personally involved on behalf of his employer with the acquisition by USSC of participations in connection with an Acquisition and Development Loan ("A & D Loan") and a Construction Loan, made by American Fletcher Mortgage Company ("AFMC") to Justin Development

Corporation to finance a major condominium construction project in the Town of Cromwell, Connecticut. Affiant has been active on behalf of USSC during the entire period of its involvement with the Cromwell project and has personally participated in virtually all dealings with AFMC in connection with such project.

2. Copies of the executed participation agreements are hereto attached and made a part hereof as "Exhibit A" and "Exhibit B", respectively.

3. USSC has never construed the participation agreements as assigning to it any interest in the unpaid indebtedness of Justin Development Corporation, or the security therefor, as distinguished from amounts received by AFMC in repayment of such indebtedness, or realized from foreclosure or sale of the security, and USSC has never interpreted the participation agreements as conferring upon it any rights against the borrower, Justin Development Corporation, whatsoever.

4. At no time has AFMC, or any officer or employee of AFMC, given any indication to Affiant, by word or deed, of any belief on the part of AFMC or its representatives that the attached participations conferred upon USSC any right in the unpaid indebtedness, or the security therefor, or any rights against Justin, the borrower, whatsoever.

5. At no time has affiant received any indication from the borrower, Justin Development Corporation, or any representative of the borrower, of any belief on Justin's part that USSC had any rights or claims against Justin.

6. Proof that AFMC and Justin Development Corporation regarded USSC as having no interest in the unpaid indebtedness, or security therefor, is established by the settlement between those two parties (as well as the contractor, Jobco, Inc.), made on October 10, 1975. When that settlement, which included the release of all claims against Justin and Jobco, Inc. and Jobco's Bonding Company, was consummated, USSC was not required or

invited to execute any of such releases, and in fact was not even furnished with copies of the executed settlement documents or releases prior to the commencement of this litigation.

7. And further affiant saith nought.

/s/ Stanley J. Mack
Stanley J. Mack

State of Florida)
) SS:
County of Dade)

Sworn to before me and subscribed in my presence this 6th day of March, 1980.

/s/ Marjorie D. Bailey
Notary Public

My Commission Expires:
12/25/82

MAR 27 1981
ALEXANDER L. STE
CLERK

IN THE

Supreme Court of the United States

October Term, 1980

No. 80-1484

U.S. STEEL CREDIT CORPORATION,

Petitioner,

v.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY and AMERICAN FLETCHER CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court of Appeals For The Seventh Circuit

BRIEF OF RESPONDENTS IN OPPOSITION

Theodore R. Boehm
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810 Fletcher Trust Building
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Attorneys for the Respondents

Central Publishing Company, Inc., Indianapolis, IN 46206

QUESTION PRESENTED

Did petitioner's participation in mortgage loans made to a developer for the construction of a condominium project involve a "security" within the meaning of the federal securities laws under the tests set forth by this Court applied to the facts of this case?

AFFILIATE OF RESPONDENTS

The only affiliate of the Respondents, other than wholly-owned subsidiaries, is American Fletcher Suisse, a Swiss corporation. American Fletcher Mortgage Investors, a Massachusetts real estate investment trust, was a co-participant in the loans involved.

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Other Authorities

Note, *The Colocotronis Dispute: When Is A Loan Participation Share A Security*, 13 J. Intl. Law & Econ. 165 (1978) 6

IN THE

Supreme Court of the United States

October Term, 1980

No. 80-1484

U.S. STEEL CREDIT CORPORATION,

Petitioner,

v.

AMERICAN FLETCHER MORTGAGE COMPANY, INC., AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY and AMERICAN FLETCHER CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court of Appeals For The Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

The respondents American Fletcher Mortgage Company, Inc. ("Mortgage Company"), American Fletcher National Bank and Trust Company ("AFNB") and American Fletcher Corporation ("AFC") respectfully request that this Court deny the petition for writ of certiorari. The only affiliate of the respondents, other than wholly owned subsidiaries, is American Fletcher Suisse, a Swiss corporation. American Fletcher Mortgage Investors, a Massachusetts real estate investment trust, was a co-participant in the loans involved.

OPINION BELOW

The version of the court of appeals' decision reproduced in petitioner's appendix italicizes various portions of the opinion that are not italicized in the opinion as published in the slip opinion or in the report which appears at 635 F.2d 1247.

QUESTION PRESENTED

Did petitioner's participation in mortgage loans made to a developer for the construction of a condominium project involve a "security" within the meaning of the federal securities laws under the tests set forth by this Court applied to the facts of this case?

STATEMENT OF THE CASE

Background

This case arose from the events following the collapse of a condominium project near Hartford, Connecticut. The project was conceived in 1973 and ground to a halt in the real estate recession of 1974-1975. The petitioner, U.S. Steel Credit Corporation ("Steel"), was one of three participating lenders to the project. The respondent Mortgage Company was the "lead lender" under contracts with each participant. Pursuant to "participation agreements" with the Mortgage Company, Steel made 40% of the loans and was entitled to 40% of all principal repayments and interest paid by the borrower. The other two participants had contracts with the Mortgage Company that differed from Steel's in several respects, but in general the Mortgage Company was to handle the day-to-day administration of the loans for all three. The other two participants were American Fletcher Mortgage Investors, a Boston-based, Massachusetts business trust ("the Trust") which took 50% of the loans, and the respondent AFNB with 10%. The Trust is publicly owned and is controlled by an independent board of trustees. Its daily affairs are handled by the Mortgage Company under a management

agreement. AFNB and the Mortgage Company are sister subsidiaries of the third respondent AFC, a bank holding company.

Proceedings Below

This lawsuit began in May, 1976, after the lenders had elected to take over the project from the developer. The Mortgage Company initially sued Steel for breach of Steel's contractual obligation to fund 40% of the disbursements made to the developer under the loans. The Mortgage Company and AFNB later asserted additional claims against Steel alleging that Steel breached its obligations as a loan participant and interfered with the Mortgage Company's efforts to salvage the project and minimize the losses of all lenders.

Steel counterclaimed against the Mortgage Company for common law fraud and breach of contract in addition to alleged violations of antifraud provisions of the securities laws. The contracts allegedly breached are the participation agreements between Steel and the Mortgage Company. The facts alleged in support of Steel's state law claims are the same facts on which Steel seeks relief under the federal securities laws. Steel's common law claims have not been challenged by pretrial motion.

The record in this case consists of the pleadings, the participation agreements, various other loan documents, affidavits and deposition excerpts. On this record— which presented no disputed facts—both courts below concluded that Steel's participation in the loans for this condominium project did not constitute a "security" within the meaning of the federal securities laws under standards set forth in decisions of this Court. Accordingly, Steel's securities claims were dismissed. All remaining claims of all parties are set for trial on August 17, 1981.

The Transaction

Loan participations in real estate projects of this type are

normally at least $1 million per participant. The participants are large, sophisticated financial institutions such as banks, real estate investment trusts and finance arms of industrial complexes. As the Court of Appeals observed, Steel, like most participants, had the same basic rights as any commercial lender: "Steel retained the rights of a lender to demand foreclosure, preclude substitution or release of collateral, prevent modification of terms of loan obligation, and so on." Appendix 14a. The borrowing was for a designated purpose—the acquisition and development of land and the construction of 150 condominium units. Appendix 13a. The Court of Appeals also noted that the loan was secured by a mortgage on the real estate and was guaranteed by the principals of the development corporation. Appendix 14a. The return to Steel was in the form of interest at a fixed rate floating above the prime rate as prime changed from time to time. It was in no way dependent upon profits of the project. Appendix 13a. Steel's decision to participate in the loans for the condominium project was based upon its own business judgment after its own analysis of the proposed project. Appendix 13a. In short, as the courts below held, Steel's participation in the loans was a commercial real estate loan, not an investment in a "security."

REASONS FOR DENYING THE WRIT

1. The Issues Presented By The Petition Involve Only The Application Of Established Law To The Facts Of This Case

The result here was based upon the standard tests of a "security" within the meaning of the federal securities laws as applied to the facts of this case. The courts below followed the firmly established principles set forth in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), and *Securities Exch. Comm'n. v. W. J. Howey Co.*, 328 U.S. 293 (1946). The *Forman* case holds that literal inclusion within the statutory laundry list of "securities" in

the Securities Exchange Act of 1934 and the Securities Act of 1933 is not determinative. Noting that the statute itself explicitly calls for reference to "the context" of a transaction, this Court in *Forman* held that the focus of a court's determination should be on the "economic reality" of the transaction. Whether or not the federal securities laws apply depends upon four factors:

> "[T]he presence of (1) an investment (2) in a common venture (3) premised on a reasonable expectation of profits (4) to be derived from the entrepreneurial or managerial efforts of others."

421 U.S. at 852 (numbers inserted).

Steel does not ask for any change in the *Howey-Forman* test. No pure law question is presented. Steel conceded that the underlying notes from the developer were not "securities," notwithstanding their inclusion on the statutory list. Correspondingly, the respondents conceded that a participation in a note which itself is not a security *may* under some circumstances be a security if the *Forman* and *Howey* tests are satisfied. Thus, as recognized by the Court of Appeals below,

> "The sole issue is whether Steel's loan participation was a security under the quadruple test developed by the case law."

Appendix 12a. After review of the specific agreements and circumstances involved here, the Court of Appeals found three of the four requirements lacking, and accordingly found no "security." That presents no issue of significance to this Court.

2. The Courts Below Correctly Applied Precedents Of This Court To The Facts Of This Case

The terms of the "participation agreements" were among the facts in the record on which the courts below focused. Their terms are reproduced in Steel's Appendix at pages

45a-49a. These agreements were authored by Steel for this particular project. They defined the various rights and obligations of Steel as a participant and the Mortgage Company as the lead lender. They provided that Steel acquired a "ratable participating share of 40%" in each of the two loans to the developer. Participation Agreement ¶ 1a. The participations were not transferable. ¶ 8. The Mortgage Company, as lead lender, was the nominal party to the loan agreements, mortgages and notes with the developer. However, the Mortgage Company's role was limited to "the processing, closing and administration of the loan obligation" for which it received a small fee. ¶ 1a. The loans were to be disbursed from time to time by the Mortgage Company after first receiving the necessary funds from the participants. ¶ 3. Likewise, payments by the developer of interest and principal were to be remitted promptly to Steel upon receipt by the Mortgage Company. ¶ 5. There was no discretion in the Mortgage Company to fail to remit or to allocate proceeds among the participants.

The participation agreements reserved to Steel virtually all significant rights of a lender.[1] Steel determined to participate in these loans to the developer on specific terms for a specific project. The Mortgage Company had no authority to select other loans and could not modify any of the terms of the loans without Steel's consent. ¶ 2. Nor could the Mortgage Company release or substitute any of the security for the loans without Steel's consent. ¶ 2. The Mortgage Company had no discretion as to the application

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[1] In this respect the arrangement appears to be materially different from the lending devices—also styled "participations"—common in international shipping finance. In that arena, where the participants are numerous and scattered all over the world, administrative ease apparently requires delegation to the lead lender of major discretion, leaving the "participants" much more like the passive investors one associates with a security. *See* Note, *The Colocotronis Dispute: When Is A Loan Participation Share A Security*, 13 J. Int'l. Law & Econ. 165, 180 (1978).

of the loan proceeds as between itself and the participants, nor as among participants. In the event of a material default, Steel reserved the right to require collection of the loans. ¶ 6. Consistent with the ongoing role Steel thus withheld for itself, the agreements expressly limited the Mortgage Company's liability to "wilful misconduct, bad faith or gross negligence." ¶ 5.

The interest on the loans was fixed by the notes as a percentage over floating prime rates. It did not, however, vary as a result of anything the Mortgage Company, the developer or Steel did or did not do. There was no participation by Steel or the Mortgage Company in any profits of the project. The loans were collateralized by the real estate and the improvements to be constructed on it. The value of the things to be acquired or done with the $5,820,000 loaned to the developer—the land, site development (roads, utilities, etc.), amenities (clubhouse, swimming pool, tennis courts, etc.) and the first 150 condominium units—was appraised at over $8,000,000. The loans were also backed by the personal guarantees of the principals of the development corporation.

Moreover, there was no public offering of the participation; indeed, Steel and the other two participants were the only lenders asked to participate. Before making the loan, Steel performed its own analysis on its own "loan proposal" form. It also conducted a thorough investigation of the proposed project including the review of a professional independent appraisal, a market and feasibility study and elaborate data with respect to the development corporation, its principals, the guarantors of the loan and the general contractor. Representatives of Steel traveled to Connecticut and inspected the site and surrounding area. During the course of construction on the project, Steel made additional site inspections and "loan progress reports."

Based upon its analysis of the foregoing undisputed facts in view of the *Howey-Forman* test, the Court of Appeals correctly concluded that Steel's participation was not an "investment" within the meaning of the test but rather a conventional commercial real estate loan based on normal lending considerations (credit, collateral, purpose of borrowing, etc.). Appendix 12a, 13a. The courts below also correctly held that Steel's independent investigations and monitoring of the project and the extent of its contractual control over the management of the loan negated any suggestion that Steel was dependent upon any entrepreneurial or managerial efforts by the Mortgage Company. Appendix 14a. Finally, there was no expectation of "profits" within the meaning of the tests. Steel's only return was in the form of interest at a fixed rate which would not vary with the profitability of the project. Appendix 13a.

The Court of Appeals performed precisely the sort of analysis *Forman* dictates. Steel's suggestion that the Seventh Circuit's decision in this case is contrary to this Court's decision in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), is without basis. Steel cites *Tcherepnin* as support for its proposition that the interest on these loans constitutes profit. Steel Petition 17, 18. The *Tcherepnin* investors, however, received "dividends" on their withdrawable savings and loan shares, not interest as Steel claims. *Tcherepnin* expressly noted that the "dividends" involved in that case were dependent upon the profits of the savings and loan association as a whole. 389 U.S. at 337-39. In contrast, Steel's interest was due, like any other lender's, without regard to the success of the project.

3. The Seventh Circuit's Decision Is Consistent With Prevailing Authority—There Is No Conflict Among The Circuits

Steel urges a return to the now discredited doctrine that anything literally in the statutory list (for example, every

"note" incident to every commercial loan) is a security. But in 1975 this Court in *Forman* expressly denounced the Second Circuit's literal approach in favor of consideration of the "context" and the "economic realities" of the transaction and observed:

> "With the exception of the Second Circuit, every court of appeals recently to consider the issue has rejected the literal approach urged by respondents."

421 U.S. at 849, n. 14.

Since this Court's *Forman* decision in 1975, the only other court of appeals which has considered whether a participation in a loan is a "security" under similar facts is the Fifth Circuit. In *United American Bank of Nashville v. Gunter*, 620 F.2d 1108 (5th Cir. 1980), that court reached precisely the same result as the Seventh Circuit did here. In doing so, the Fifth Circuit expressly overturned its own earlier decision in *Lehigh Valley Trust Co. v. Central Nat'l. Bank*, 409 F.2d 989 (5th Cir. 1969). *Lehigh Valley* was the only Court of Appeals decision that had held that a participation in a loan was a security. However, *Gunter* noted that *Lehigh Valley* was decided using a "literal approach" to the definition of "security" which had since been rejected by this Court in *Forman* in favor of an analysis turning on the "economic realities" underlying the transaction. *United American Bank of Nashville v. Gunter, supra*, 620 F.2d at 1115. Thus, the only appellate court decision differing with the result reached by the Seventh Circuit in this case has been repudiated by the same circuit that decided it. There is no conflict among the circuits.

Since *Forman*, three district court decisions (in the First, Third and Sixth Circuits) have also reached the same result as the Seventh Circuit under analogous facts. *The Manchester Bank v. Connecticut Bank & Trust Co.*, 497 F. Supp. 1304 (D. N.H. 1980); *Provident Nat'l. Bank v. Frankford Trust Co.*, 468 F. Supp. 448 (E.D. Pa. 1979); *FBS*

Financial, Inc. v. CleveTrust Realty Investors, [1978] Fed.Sec.L.Rep. (CCH) ¶ 96,341 (N.D. Ohio 1977). *See also Home Sav. & L. Assn v. Samuel T. Issac & Assoc.*, [Current] Fed.Sec.L.Rep. (CCH) ¶ 97,811 (N.D. Ill. Sept. 8, 1980), in the Seventh Circuit predating the decision of the Court of Appeals in this case.

Two post-*Forman* district court decisions from the Southern District of New York have found the participation interests involved in the cases before them to be securities. *Commercial Discount Corp. v. Lincoln First Commercial Corp.*, 445 F. Supp. 1263 (S.D.N.Y. 1978), and *NBI Mortgage Investment Corp. v. Chemical Bank*, [1976-1977] Fed.Sec.L.Rep. (CCH) ¶ 95,632 (S.D.N.Y. 1976), and [1977-1978] Fed.Sec.L.Rep. (CCH) ¶ 96,066 (S.D.N.Y. 1977). But both decisions deal with different facts and significantly different participation agreements. For example, the *NBI* and *Commercial Discount* participants had no right to demand foreclosure, as Steel did here. Given the myriad relationships that the banking community reaches in various transactions, it is hardly surprising that different transactions may produce different results. But there is no basic difference in the legal doctrines involved in any of these cases.

Steel appears to be urging this Court to reconsider *Forman* which rejected the Second Circuit's now discredited "literal" approach. In its petition, Steel says that the "[Second Circuit's] liberal approach to the 'securities' acts definitions . . . stands in marked contrast to the restrictive interpretation of the Seventh and some other circuits." Steel Petition 12. But the Second Circuit has not dealt with any loan participation case since *Forman*, much less with one identical to Steel's. If and when the Second Circuit finds a security in a loan participation, notwithstanding the views of the Fifth and Seventh Circuits, then and only then will this Court need to consider whether there is a conflict worth reviewing. None presently exists and there is no reason to suppose the Second Circuit will not follow and apply *Forman* if the issue does arise.

4. The Presumption Contention Was Not Raised Below And Is Inappropriate For Review

Steel also now seeks to contend that the Second Circuit's decision in *Exchange Nat'l. Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976), which is not a loan participation case, holds that anything literally falling within the statutory definition of "security" is presumed to be a security unless the opposing party sustains the burden of showing that "the context otherwise requires." Steel Petition 13. Steel implies the decision below is inconsistent with this view. Steel, however, did not raise this presumption issue in the courts below and neither court addressed it. Moreover, respondents submit that the record amply supports the conclusions reached by both courts below regardless of any such presumption.

5. This Case Presents No Unresolved Important Question Of Federal Law

No party to this action has argued that a participation in a note is either always or never a security within the meaning of federal securities laws. Indeed, respondents conceded—and the Seventh Circuit assumed—that a participation in a note may be a security under some circumstances. All that is at issue here is the application of familiar tests to the facts of this particular case. Respondents submit that both courts below fully considered the "economic realities" of the situation in arriving at their result. These included the nature, purpose and collateral of the loan, who the participants were, what they did and the relationship between Steel and the Mortgage Company as reflected in the participation agreements.

Finally, state law adequately covers the subject of a participant's rights vis-a-vis a lead lender in a case such as this. Like virtually all loan participants, Steel is a large and sophisticated institutional lender in the business of making multimillion dollar loans to real estate developers. The participants and lead lenders in transactions of this type are fully capable of fending for themselves. They can negotiate whatever duties and standards of liability they wish. In this case the parties defined their relationship with a contract that specified ongoing rights and responsibilities and established a standard of liability for "gross negligence or willful misconduct." Steel's claims against the Mortgage Company for common law fraud and breach of the participation agreements are to be tried in a few months. Steel has perfectly adequate remedies under the state law claims it has asserted. This Court has recently and repeatedly declined to interpret the federal securities laws to expand into areas adequately served by state law. *See, e.g., Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 478-79 (1977), and *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APR 15 1981
ALEXANDER L. STEVAS
CLERK

In the

Supreme Court of the United States

OCTOBER TERM, 1980

U.S. STEEL CREDIT CORPORATION,

Petitioner,

vs.

AMERICAN FLETCHER MORTGAGE COMPANY, INC.,
AMERICAN FLETCHER NATIONAL BANK AND TRUST COMPANY, and
AMERICAN FLETCHER CORPORATION,

Respondents.

PETITIONER'S REPLY BRIEF

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The Scheffer Press, Inc.—(312) 263-6850

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Respondents.

PETITIONER'S REPLY BRIEF

The most notable feature of Respondents' Brief is its failure to come to grips with any of the substantive points raised in U. S. Steel Credit Corporation's Petition for Certiorari, other than by ritual repetition of the very mispronouncements which prompted the Petition.

Thus, on the question, whether interest is a form of "profits" within the meaning of the *Howey-Forman* test, Respondents merely parrot the Court of Appeals' holding that interest is not profits, because it involves a fixed rate of return which does not fluctuate with profits (Resp.

Br., p. 8). How, then, can any of the interest-bearing instruments, which Congress described as "securities" in its statutory definitions, qualify as "securities"? And what about the "economic reality," noted in *Williamson* v. *Tucker*, 632 F.2d 579, 604 (5th Cir. 1980), that without profits there will be no return of interest or principal on the notes? Respondents offer no answer to these questions, raised in our Petition (Pet. pp. 16-17).

Again, Respondents point to the Court of Appeals' finding that there was no "expectation of profits to be derived from the entrepreneurial or managerial efforts of others," because Petitioner's decision to participate "was based upon its own business judgment" (Resp. Br. p. 4, 7). Does *Forman*[1], then, require that the "expectation" of profits, no less than the profits themselves, must derive—and derive "solely"—from the efforts of others? Do the Securities Acts protect only *imprudent* investors? Respondents attempt no answers to these questions, posed in our Petition (Pet. pp. 18-20).

Respondents recite the Court of Appeals' holding that Petitioner's participations failed the *Howey-Forman* profits-derivation test because the Mortgage Company had no authority to modify the loan agreement, release the security, or decline to foreclose in the event of a default, without Petitioner's consent (Resp. Br. pp. 6-7). How, then, can a corporate mortgage bond qualify as a "security," since a bondholder has all of the above rights (Pet. pp. 12, 24-25)? These rights, moreover, are not profit-producing. They are stop-loss precautions at best. Here again Respondents seek to dispose of these points by ignoring them.

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[1] *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 852, 95 S.Ct. 2051, 2060 (1975).

Like the Court of Appeals, Respondents attempt to gloss over important distinctions between the posture of the lead bank as a commercial lender and the posture of an investor in a loan participation (see Pet. pp. 18, 21-22, 24) by repeatedly misdescribing USSC as a "lender" and its participation as a "loan" (Resp. Br. pp. 2, 3, 4, 6, 7, and 12). Beyond this exercise in false labeling, plus unsupported assertions that Petitioner had "all significant rights of a lender" (Resp. Br. p. 6), Respondents fail to specify a single creditor's right possessed by USSC. Though Respondents seek to pass off the Mortgage Company as a mere "nominal party to the loan agreements" (p. 6), no one has yet suggested that any of the participants, least of all USSC, had any rights against the borrower. The "economic reality" of lacking rights against the borrower was forcefully brought home to USSC when the Mortgage Company took it upon itself to release the borrower, the mortgage, the contractor, and the contractor's bonding company, without (so we contend) USSC's consent.

USSC was not even a creditor of the Mortgage Company. When, in response to periodic draw requests from the Mortgage Company, USSC made payments to the Mortgage Company, USSC had no absolute right to repayment, even of principal, much less interest, on these payments. Loans, by definition, are "obligations to repay absolutely", *Depositors Trust Company* v. *Maryland Casualty Company*, 174 A.2d 288, 291 (Md. 1969); *In Re Grand Union Company*, 219 F. 353, 356 (2d Cir. 1915). It is true that USSC had a right to share in whatever sums, if any, the Mortgage Company might collect from the borrower. But this *conditional* right to share in receipts does not make USSC a "lender" any more than

an income beneficiary of a trust is a "lender," by reason of his conditional right to share in any income realized by the trust. Respondents come to grips with none of these points.

Beyond the superficiality of Respondents' arguments, Respondents' Brief is riddled with potentially misleading inaccuracies:

1. Contrary to Respondents' assertion in footnote 1 on page 6 of their Brief, there do not appear to be any significant differences in terms between the participations involved in the Colocotronis loans and the participations in the case at bar. Colocotronis merely highlights the importance of distinguishing between the posture of a loan participant and that of a lead bank, vis-a-vis the loan, because of the great geographical distances between the participants and the borrower's activities, which existed in Colocotronis. See Notes, *The Colocotronis Dispute: When is a Loan Participation Share a Security?* 13 J. Int'l. Law & Econ. 165 (1978) and *Loan Participations as Securities,* 8 Cal. W. Int'l. L. J. 510 (1978). The opinion of commentators that loan participations should qualify as "securities" is not limited to international loans. See *Bank Loan Participations: The Affirmative Duty to Disclose Under SEC Rule* 10b-5, 27 Syracuse L. Rev. 807 (Spring, 1976).

2. Contrary to the statement on page 10 of Respondents' Brief, there is nothing in the recital of facts in *Commercial Discount Corp.* v. *Lincoln First Commercial Corp.*, 445 F.Supp. 1263 (SDNY 1978) or in *NBI Mortgage Investment Corp.* v. *Chemical Bank* [1976-1977] Fed. Sec. L. Rep. (CCH) ¶95,632 (SDNY 1976) and [1977-1978] Fed. Sec. L. Rep. (CCH) ¶96,066 (SDNY 1977) to

indicate that the loan participants in those cases had no voice in foreclosure decisions.

3. Contrary to the statement on page 10 of Respondents' Brief, U. S. Steel Credit Corporation has never urged a return to the literal approach of *Lehigh Valley Trust Co.* v. *Central National Bank of Jacksonville,* 409 F.2d 989 (5th Cir. 1979) in determining whether or not a loan participation qualifiies as a "security" (Pet. p. 13-14, 22). Petitioner's point is not that the *Howey-Forman* tests should be changed, but merely that the Court of Appeals has misconceived and misapplied them (Pet. p. 12, 17, 20).

4. Equally untrue is Respondents' statement on page 11 that the presumption of "security" status, announced by the Second Circuit in *Exchange National Bank* v. *Touche Ross & Co.,* 544 F.2d 1126 (1976), with respect to instruments defined as "securities" in the Acts, was never pointed out in USSC's briefs, below.[2] In point of fact, *Exchange National Bank* v. *Touche Ross & Co.* was fully analyzed and discussed on page 13 of USSC's Reply Brief before the Court of Appeals, where this statement appears:

> "*Exchange National Bank* differs from other jurisdictions in its construction of the Securities Acts definitions, only in one respect: i.e. that if a particular instrument, like a 'note,' is expressly defined in the Act as a 'security,' the burden shifts to the party contesting 'security' status to prove that the 'context otherwise requires' ".

---

[2] This marks the second time in this appeal in which counsel for the Mortgage Company have falsely charged USSC with failing to argue below points which in fact had been carefully briefed below. (See Court of Appeals' opinion, fn. 4, App. 7a.)

Consistent with their usual ploy of mislabeling that which cannot otherwise be discredited, Respondents characterize the Second Circuit's approach to the Securities Act definitions as a "literal" approach (Resp. Br. p. 10). Any objective reading of Judge Friendly's exhaustive opinion in *Exchange National Bank* reveals, however, that the Second Circuit gives full consideration to the context. This decision does impose upon the party opposing security status the burden of proving that an instrument defined by Congress as a "security" is "required" (not merely permitted) by the context to be regarded as a non-security.

The Second Circuit's approach to the "security" question is a better approach than that of the Seventh Circuit for at least two reasons. First, the Second Circuit, while not confining its attention to the language of the Acts, pays heed to the statute, while the Seventh Circuit tends to *ignore* the statutory language. Thus, the Second Circuit would never fall into the error of holding, as the Seventh Circuit has done in the case at bar, that interest is not a form of profits, because that holding effectively reads out of the statute interest-bearing instruments, like notes, certificates of deposit, and loan participations, which Congress plainly contemplated would qualify as "securities" in most instances. The test of "security" status of a loan participation should not be whether it has the attributes of a share of stock, but whether it has the attributes of a fixed-return "security" like a corporate mortgage bond. Consistent with the statute, the Second Circuit's presumption is one of *inclusion,* whereas the Seventh Circuit's restrictive approach militates toward *exclusion.*

Secondly, the Second Circuit's presumptive inclusion rule not only fits the language of the statute; it also complies with the repeated urgings of the Supreme Court that the Securities Acts should be broadly and flexibly construed to achieve their remedial purposes. *Aaron* v. *SEC,* 100 S.Ct. 1945, 1960 (1980); *Tcherepnin* v. *Knight,* 389 U.S. 332, 336; 88 S.Ct. 548, 553 (1967). (See Pet. p. 11, 17.)

CONCLUSION

The crux of the matter is that the distinct trend of lower court decisions on "securities" questions is toward increasingly restrictive interpretation of the Securities Acts. The Second Circuit stands alone against this trend. If the Supreme Court remains of the view that the Securities Acts should be *broadly* construed, it is time to blow the whistle on this trend before the remedial objectives of the Securities Acts have been completely emasculated.

U. S. Steel Credit Corporation's Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit herein should be granted.

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